MONTEREY BAY BANCORP INC
Form 10-K
March 27, 2003

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K

Annual Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934 For the fiscal year ended December 31, 2002

Commission File Number: 0-24802

MONTEREY BAY BANCORP, INC.
(Exact Name Of Registrant As Specified In Its Charter)

DELAWARE	77-0381362
(State Or Other Jurisdiction Of Incorporation Or Organization)	(I.R.S. Employer Identification Number)

567 Auto Center Drive, Watsonville, California 95076
(Address Of Principal Executive Offices)(Zip Code)

(831) 768 - 4800
(Registrant's Telephone Number, Including Area Code)

(831) 722 - 6794
(Registrant's Facsimile Number, Including Area Code)

WWW.MONTEREYBAYBANK.COM
(Registrant's Internet Site)

INFO@MONTEREYBAYBANK.COM
(Registrant's Electronic Mail Address)

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act:
Common Stock, $0.01 par value per share
(Title Of Class)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes X No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2).
Yes ________ No ___X___.

The aggregate market value of the Common Stock held by "non-affiliates" of the registrant, based upon the closing price of its Common Stock on March 5, 2003 of $20.18, as quoted on the Nasdaq National Market System, was approximately $38,779,000. The aggregate market value of the Common Stock held by "non-affiliates" of the registrant, based upon the closing price of its Common Stock on June 28, 2002 (the last business day of the registrant's most recently completed second fiscal quarter) of $18.00, as quoted on the Nasdaq National Market System, was approximately $36,915,000. Shares of common stock held by each officer, director, and holder of 5% or more of the outstanding Common Stock have been excluded in that such persons or entities may be deemed to be affiliates. Such determination of affiliate status is not necessarily a conclusive determination for other purposes.

The registrant had 3,460,974 shares of Common Stock outstanding as of March 20, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2003 Annual Meeting of Stockholders to be filed within 120 days of the fiscal year ended December 31, 2002 are incorporated by reference into Part III of this Form 10-K.

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INTRODUCTION

Discussions of certain matters in this Annual Report on Form 10-K may constitute forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), and as such, may involve risks and uncertainties. Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations, are generally identifiable by the use of words or phrases such as "believe", "plan", "expect", "intend", "anticipate", "estimate", "project", "forecast", "may increase", "may fluctuate", "may improve" and similar expressions or future or conditional verbs such as "will", "should", "would", and "could". These forward-looking statements relate to, among other things, expectations of the business environment in which Monterey Bay Bancorp, Inc. operates, opportunities and expectations regarding technologies, anticipated performance or contributions from new and existing employees, projections of future performance, potential future credit experience, possible changes in laws and regulations, potential risks and benefits arising from the implementation of the Company's strategic and tactical plans, perceived opportunities in the market, potential actions of significant stockholders and investment banking firms, the potential impact of past and possible future terrorist or military actions upon consumer confidence, income, and spending, and statements regarding the Company's mission and vision. The Company's actual results, performance, and achievements may differ materially from the results, performance, and achievements expressed or implied in such forward-looking statements due to a wide range of factors. For a discussion of some of the factors that might cause such a difference, including, but not limited to, changes in interest rates, general economic conditions, technology, legislative and regulatory changes,

monetary and fiscal policies of the US Government, US Treasury, and Federal Reserve, real estate valuations, and competition in the financial services industry, see "Item 1. Business - Risk Factors That May Affect Future Results." These factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. The Company does not undertake, and specifically disclaims any obligation, to update any forward-looking statements to reflect occurrences or unanticipated events or circumstances after the date of such statements.

AVAILABILITY OF INFORMATION

Reports filed with the Securities and Exchange Commission ("SEC") including proxy statements and other information can be inspected and copied at the public reference facilities of the SEC at Room 1024, 450 Fifth Street, N.W., Washington, D.C. 20549 and 500 West Madison Street, Suite 1400, Chicago, IL. 60661. Copies of such materials can be obtained from the Public Reference Section of the SEC at 450 Fifth Street, N.W., Washington, D.C. 20549, at prescribed rates. The SEC maintains an Internet site that contains reports, proxy, and information statements and other information. The address of the site is http://www.sec.gov.

Monterey Bay Bancorp, Inc. makes available free of charge through its Internet site its Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. The Internet site address for Monterey Bay Bancorp, Inc. is http://www.montereybaybank.com.

Additional corporate information regarding Monterey Bay Bancorp, Inc. and Monterey Bay bank is also available at the www.montereybaybank.com Internet site. This Internet site is not a part of this Annual Report on Form 10-K.

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PART I

Item 1. Business

General

Monterey Bay Bancorp, Inc. (referred to herein on an unconsolidated basis as "MBBC" and on a consolidated basis as the "Company") is a unitary savings and loan holding company incorporated in 1994 under the laws of the state of Delaware. MBBC currently maintains a single subsidiary company, Monterey Bay Bank (the "Bank"), formerly Watsonville Federal Savings and Loan Association. The Bank is a federally chartered savings and loan association organized under the laws of the United States of America. The Bank was founded in 1925. MBBC was organized as the holding company for the Bank in connection with the Bank's conversion from the mutual to stock form of ownership in 1995.

The principal executive offices of the Company and the Bank are located at 567 Auto Center Drive, Watsonville, California, 95076, telephone number (831) 768 - 4800, facsimile number (831) 722 - 6794. The Company may also be contacted via electronic mail at: INFO@MONTEREYBAYBANK.COM.

At December 31, 2002, the Company had $609.7 million in total assets, $523.5 million in net loans receivable, and $458.3 million in total deposits. The Company is subject to regulation by the Office of Thrift Supervision ("OTS"), the Federal Deposit Insurance Corporation ("FDIC"), and the SEC. The

Bank is subject to certain regulations of the Board of Governors of the Federal Reserve System ("FRB") with respect to reserves required to be maintained against deposits and certain other matters.

The Bank is a member of the Federal Home Loan Bank ("FHLB") of San Francisco, which is one of the twelve regional banks comprising the Federal Home Loan Bank System. The Bank's deposits are insured by the FDIC to the maximum extent permitted by law.

The Company conducts business from eight full-service branch offices in its primary market area in Central California, one loan production office in Los Angeles, 11 automated teller machines ("ATM's") including two stand-alone ATM's, and its administrative facilities in Watsonville, California. The Company's headquarters building in Watsonville also functions as a limited service branch office. In addition, in March 2003, the Company was in the process of finalizing a lease for a full service de novo branch in Pacific Grove, California, within its primary market area. Should a final lease be executed and all regulatory and local approvals and permits be obtained in a timely manner, the Company anticipates opening the new full service branch in the third quarter of 2003.

The Company also supports its customers through Internet Banking for both consumers and businesses, 24 hour bilingual (English / Spanish) telephone banking, electronic bill payment, remote deposit capability, courier service, bank by mail, night depository, and ATM access through an array of ATM networks including STAR, CIRRUS, and PLUS.

Through its network of banking offices, the Bank emphasizes personalized service in assisting individuals, families, professionals, community organizations, non-profit organizations, and businesses in attaining their financial objectives. The Bank offers a wide complement of lending products, including:

- a broad array of residential mortgage products, both fixed and adjustable rate
- consumer loans, including home equity lines of credit and overdraft lines of credit
- specialized financing programs to support community development
- mortgages for multifamily real estate
- commercial and industrial real estate loans
- construction lending for single family residences, apartment buildings, and commercial real estate
- commercial loans to businesses, including both revolving lines of credit and term loans

The Bank also provides an extensive selection of deposit instruments. These include:

- multiple checking products for both personal and business accounts, with imaged statements available

- various savings accounts
- tiered money market accounts offering a variety of access methods
- tax qualified deposit accounts (e.g. IRA's)
- a broad array of certificate of deposit products

Through its wholly-owned subsidiary, Portola Investment Corporation ("Portola"), the Bank provides, on an agency basis, life insurance (term, whole life, and universal life insurance), long term care insurance, tax qualified plans including Section 529 plans and 401(k) plans, and a wide selection of non-FDIC insured investment products including:

- fixed annuities
- variable annuities
- an extensive inventory of mutual funds
- individual fixed income and equity securities

Please see "Subsidiary Activities" for additional information regarding business activities by Portola.

The Bank also supports its customers by functioning as a federal tax depository, selling and purchasing foreign banknotes, issuing debit and ATM cards, providing domestic and international collection services, furnishing trade finance services, and supplying various forms of electronic funds transfer.

The Company participates in the wholesale capital markets through the management of its security portfolio and its use of various forms of wholesale funding. The Company's security portfolio contains a variety of instruments, including collateralized mortgage obligations ("CMO's"). The Company also participates in the secondary market for loans as both a purchaser and a seller of various types of loan products.

The Company's revenues are primarily derived from interest on its loan and mortgage backed securities portfolios, interest and dividends on its investment securities, and fee income associated with the provision of various customer services. Interest paid on deposits and borrowings typically constitutes the Company's largest type of expense. The Company's primary sources of funds are deposits, principal and interest payments on its asset portfolios, and various sources of wholesale borrowings including FHLB advances, federal funds purchased, and securities sold under agreements to repurchase. The Company's most significant operating expenditures are its staffing expenses and the costs associated with maintaining its branch network.

Additional information concerning the Company's business is presented under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Company Strategy

During the past several years, the Company has implemented a business strategy of evolving away from its traditional savings and loan roots and into a community focused commercial bank serving the financial needs of individuals, families, professionals, organizations, and businesses. This business strategy

was selected:

- so that the Company might better and more completely address the financial needs of the communities it serves

- because of the constrained financial returns associated with the traditional thrift business of funding residential mortgage loans with certificates of deposit for entities the size of the Bank

- due to the increasing commoditization of residential mortgages, spurred by new technologies and revised business practices supported by Federal Agencies such as the Federal National Mortgage Association ("FNMA" or "Fannie Mae") and the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac")

- to augment stockholder value, as the Company believes that successful community commercial banks generally receive a more favorable valuation in the capital markets than traditional savings and loans

- to develop more robust and recurring sources of income

The Company's community commercial banking strategy incorporates:

- a relationship based approach to customer service, marketing, product design, and pricing

- a focus on understanding the profile and objectives of the Company's customers as a means to provide enhanced service while also supporting credit quality

- a high level of community involvement and visibility by the Company, its directors, and its employees

- a balance sheet profile presenting loan and deposit portfolios diversified among multiple products

- a ratio of net loans to total assets of between 85.0% and 90.0%

- income property, construction, and commercial business loans representing a greater percentage of total loans than has been maintained in the past, with a reduced concentration in residential mortgages

- a deposit mix with a greater percentage of transaction accounts than has been maintained in the past, with a lower concentration of certificates of deposit

- increasing fee income to a greater portion of total revenue than historically generated

- utilizing new technologies to better meet the financial needs of individuals, families, professionals, and businesses

The Company's business strategy incorporates consideration of a future conversion to a commercial bank charter. Such a change in charter to either a California State chartered commercial bank or a nationally chartered commercial bank would be primarily driven by the Bank's changing asset mix, as the Bank expects to eventually fall below the minimum thresholds for federally chartered thrifts under the Qualified Thrift Lender ("QTL") test as it conducts additional commercial real estate and commercial business lending. At December 31, 2002, the Bank was under no immediate pressure to pursue a change in charter, as the Bank's QTL ratio at that time was 68.4%, compared to a regulatory minimum of 65.0%. In addition, the Bank has certain elections available that would allow

continued operation as a federally chartered thrift even with a QTL ratio below 65.0%.

As discussed below and throughout this Annual Report, the Company has achieved progress in regards to its strategic plan over the past several years, including some particular accomplishments in 2002.

Key Company Accomplishments

In general, the Company's recent accomplishments can be grouped into four categories:

1. The achievement of historically favorable financial results in 2002, including:

   A. the generation of the highest levels of net income and earnings per share in the Company's history, with six consecutive quarters of record quarterly earnings through the quarter ended December 31, 2002

   B. increases in return on average assets and return on average stockholders' equity to the highest annual levels in the Company's history

   C. significant improvement in the Company's efficiency ratio, with such ratio declining from 64.41% in 2001 to 55.78% in 2002 (53.41% during the fourth quarter of 2002)

   D. a rise in the Company's stock price from $15.50 per share at December 31, 2001 to $19.95 per share at December 31, 2002 despite a challenging capital markets environment

2. The increased visibility of the Bank, which in turn led to greater volumes of business, as a result of:

   A. a further expansion in the Company's commitment to its local communities, as exemplified by the Bank's active support of a wider range of community organizations and events, and by an increased amount of time donated by the Company's directors and employees

   B. increased advertising aimed at heightening local market awareness of the expanded range of financial services offered by the Company

3. The continued investment in and implementation of the human resource, product inventory, distribution channel, and technology foundations necessary to successfully implement the Company's business strategy, including:

   A. the recruitment in early 2003 of a veteran commercial banker with in-market experience to serve as the Bank's Director of Retail Banking

   B. the hiring of additional commercial business relationship officers and experienced commercial bank branch managers

   C. the introduction of remote deposit services, Internet banking

for businesses, letters of credit, and new deposit products for both businesses and individuals

D. the opening of the Los Angeles loan production office during the first quarter of 2002

E. the designation of the Bank's administrative headquarters as an additional (limited service) branch office

F. identification of a desirable site for a de novo full service branch in the Bank's primary market area

G. upgrades of the Company's telecommunications network, primary data processing equipment, and disaster recovery capabilities

4. The enhancement of stockholder value, as subsequently discussed

Additional information regarding the Company's strategic plan and its accomplishments in relation thereto is presented in the following paragraphs and throughout this Annual Report.

The loan portfolio product mix of loans held for investment shifted during 2002 in conformity with the Company's strategic plan. Residential one to four unit loans declined from 42.2% of gross loans held for investment at December 31, 2001 to 33.1% at December 31, 2002. In contrast, commercial and industrial real estate loans rose from 22.7% to 24.7%, construction loans increased from 7.9% to 12.3%, land loans increased from 2.5% to 4.4%, commercial business loans rose from 1.8% to 3.1%, and consumer loans (primarily home equity lines of credit) increased from 1.5% to 1.6%. This change in loan mix was facilitated by the commercial business and real estate relationship officers the Company hired over the past year and by the new Los Angeles loan production office, which concentrates on income property and construction lending. This loan production office is managed by a veteran banker with significant experience in Southern California, long-standing relationships with area developers and property investors, and particular expertise in marketing and underwriting construction and income property credits. The opening of this office advanced the geographic diversification of the Company's real estate loan portfolio, which has been historically concentrated in the California counties of Santa Cruz, Monterey, and Santa Clara.

At December 31, 2002, certificates of deposits constituted 53.8% of the deposit portfolio, down from 56.4% at December 31, 2001. Certificates of deposit would have reflected a smaller percentage of the deposit portfolio at December 31, 2002 if not for the Bank's:

- acquiring an additional net $9.0 million in certificates of deposit through the State of California Time Deposit Program during 2002, whereby the State of California makes deposits available to support reinvestment back into California communities

- issuing a $20.0 million brokered CD in May 2002 to provide funding for the Company's strong loan demand

Over the past several years, the Company has emphasized checking and money market accounts in its marketing, new product development, and advertising as a means of cementing its relationship with its customers, decreasing its relative cost of funds, and bolstering non-interest income.

The Company's strategy of transitioning into a community commercial

bank also incorporates increasing the percentage of the Company's total revenues generated from fees and service charges, as compared to net interest income. In this regard, the Company has expanded its scope of fee based services, altered its pricing, and enhanced the product line offered through Portola.

In implementing its business strategy, the Company intends to continue enhancing its inventory of financial products targeted at both businesses and individuals. In 2003, the Company plans to:

- expand its full service branch hours for Mondays through Thursdays

- offer payroll and merchant bankcard services for business through third-party relationships

- introduce several consumer relationship products, whereby individuals benefit from expanding their overall relationship with the Company

The Company intends to complement the new technology implemented in 2001 and 2002 during the coming year with a new item processing environment, enhanced customer statements, and various ancillary systems such as current generation safe deposit box management software.

Throughout 2002, the Company maintained its commitment to support the quality of life in the Greater Monterey Bay Area. Employees are encouraged to be involved with local community and service organizations. A significant contribution was made to advance post-secondary education, and other charitable donations of funds or services were conducted throughout the year. As just one example, during the months of November and December 2002, the Company focused its efforts on helping the less fortunate by providing food and donations to local food banks through a Holiday Food Drive Campaign. Each of the Bank's eight branches as well as the Administrative Headquarters served as public collection sites promoting donations of non-perishable food items. Through the combined efforts of employees, directors, customers, and the general public, the Company collected the equivalent of over 7,000 pounds of food.

The Company employs a Director of Community Relations, whose responsibilities include further enhancing the Company's visibility in the Greater Monterey Bay Area, improving the effectiveness of the Company's community relations program, and coordinating employee and director participation in local chambers of commerce and Rotary organizations, in addition to many special community, charity, and educational events.

The implementation of the Company's business strategy presents various costs and risks. In general, the Company incurs operating and capital expenses in advance of associated revenues, as the human and technology resources necessary to implement the strategic plan must be in place before new sales can be generated. The amount of change concomitant with this strategy, particularly given the relatively rapid pace of implementation undertaken by the Company, presents significant execution risks. Some of these execution risks include exposure in the implementation of new technology, the delivery of financial products and services with greater innate levels of operating risk, and the greater credit risk inherent in consumer and commercial (versus mortgage) lending. The Company has endeavored to mitigate these risks, in part, by:

- recruiting experienced commercial bankers for open positions within the Company

- hiring certain professionals on a consulting basis to provide technical assistance, risk assessment and testing, and asset quality review

- increasing its allowance for loan losses in both nominal and relative terms in conformity with the change in inherent risk present in the loan portfolio

The Company's Board of Directors has evolved over the past three years, with new directors adding skills in corporate governance, financial expertise, an appreciation of the importance of advancing stockholder value, and the capacity to refer local business to the Company.

In 2003, the Company intends to continue pursuing the business strategy outlined above. Furthermore, the Company plans to explore avenues for further growth in product diversification and market share, including the purchase of banking branches in the Greater Monterey Bay Area, the opening of a de novo full service branch in Pacific Grove, and / or an alignment with new vendors that can facilitate the more rapid implementation of the strategic plan.

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Stockholder Value

A key aspect of the Company's business strategy is to enhance stockholder value. The Company's efforts and achievements in this regard have included:

- Since 1995, the Company has repurchased over 1.3 million of its common shares, including 61,000 shares during 2002. At December 31, 2002, there were 53,035 remaining shares authorized for repurchase under the Company's current repurchase program.

- The Company's directors continued to receive their retainer fees in Company common stock during 2002.

- The Company's bylaws specify a minimum stock ownership requirement for all Directors.

- The Company's executive management volunteered to accept a portion of their 2002 cash incentive compensation in Company common stock, repeating elections made in prior years.

- The Company's employee stock option plan provides that stock options are issued at 110% of the fair market value of the Company's stock on the date of grant, versus the 100% level prevalent in the financial services industry.

- Incentive stock options have been awarded to the vast majority of managers in the Company, thus encouraging alignment of employee interests with those of stockholders.

- The addition of new market makers for the Company's common stock.

At its October 2002 meeting, the MBBC Board of Directors approved an increase in the total Company stock ownership requirement for Directors, subject to certain conditions, from 1,000 shares to 5,000 shares. All of the Company's directors owned at least 5,000 shares of the Company's common stock at December 31, 2002, with the exception of Ms. Rita Alves, a recently appointed director. Per the terms of the Bylaws, Ms. Alves has until September 2003 to cumulatively purchase 1,000 shares of the Company's common stock. In addition, Ms. Alves has until September 2005 to own at least 5,000 shares of the Company's common stock. At December 31, 2002, Ms. Alves owned 401 shares of the Company's common stock.

Effective November 1, 2002, the Company's directors adopted a revised director fee program. The new program provides for all director compensation of any type, other than travel reimbursement, to be paid exclusively in Company common stock on a quarterly basis. In addition, base retainer fees were reduced, with new fees implemented based upon meeting attendance and the number of Board committees served. In adopting the new director fee plan, the Board sought to even more closely align their compensation with stockholder interests by making director compensation more performance and activity based. Total annual costs under the new director fee plan are projected to be close to those associated with the prior program that was primarily focused upon flat retainer fees.

The Company's directors and officers continued to be net purchasers of the Company's common stock during 2002, with recurring purchases by the Company's Chief Executive Officer, Chief Financial Officer, and Chief Loan Officer.

A significant number of the Bank's employees have an ownership interest in the Company, through one or more of the following:

- direct stock purchases
- the Employee Stock Ownership Plan ("ESOP")
- incentive stock options
- stock grant awards
- stock purchased with funds contributed by employees to the Bank's 401(k) Plan (Company common stock is one of twelve investment options)

In addition, the Company maintains a relationship with an investment banking firm specializing in the financial services industry as a means of:

- supporting a number of initiatives aimed at increasing stockholder value
- obtaining advice regarding balance sheet, interest rate risk, and capital management
- acquiring expanded competitive information and market intelligence
- advising the Board of Directors and Management regarding trends, risks, and tactical and strategic opportunities within the financial services industry

In 2003, the Company intends to pursue additional equity analyst coverage and continuing to leverage the growing capital base in order to support further expansion in return on average stockholders' equity.

The Board of Directors and Management have targeted the transformation strategy into a community focused commercial bank based on their belief that this approach presents the best current opportunity to enhance long term stockholder value.

Corporate Governance

The Company supports strong corporate governance and has adopted policies and procedures designed to facilitate quality corporate governance. The Company's profile in regards to corporate governance at December 31, 2002 included the following:

1. All directors other than the Chief Executive Officer are outside directors with no executive position with the Company.

2. No outside directors are under consulting or similar contracts with the Company.

3. During 2002, the Board Audit Committee held 12 meetings.

4. Members of the Board Audit Committee include two active chief financial officers of private companies and one retired bank chief executive officer. The Company added the second active chief financial officer to its Board of Directors in the past year, with that individual also serving on the Board Audit Committee.

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5. All services provided by the independent auditor must be approved in advance by the Board Audit Committee.

6. The Board Audit Committee approves the annual internal audit plan and reviews all internal audit reports, credit review reports, and regulatory examinations, including Management's written response thereto.

7. The Chairman of the Board Audit Committee discusses the Company's financial results, accounting, condition, and internal controls with the independent auditor at least quarterly.

8. The Company has in place a "whistle-blowing procedure" whereby the Chairman of the Audit Committee may be confidentially and anonymously contacted by any Company employee. The Company's policy provides protections to whistle-blowing employees from retaliation and other adverse responses to whistle-blowing.

9. The Company maintains a Code of Ethics And Standards of Personal Conduct policy for all employees and a Code of Ethics policy for directors. These policies:

   A. emphasize the importance of complying with all laws and regulations and conducting business for the Company in an ethical and honest manner

   B. require employees and directors to report in writing any actual or potential conflicts of interest

   C. govern the acceptance of gifts by employees

   D. restrict Company political contributions and activities

   E. govern lending practices

   F. support the maintenance of Company and customer confidentiality in conformity with laws and regulations

   G. provide guidance for directors and employees in regards to various business activities where ethics are exposed to potential compromise

   H. address other topics and issues which could create a conflict of interest or present ethical issues to the Company, its directors, and its employees

I. delineate accountability for adherence to the policies

10. The Company maintains an Insider Trading policy that requires all directors and Section 16 SEC reporting officers to obtain approval prior to conducting any transactions in the Company's common stock and to comply with all applicable laws and regulations associated with insider trading. This policy also prohibits insiders from selling the Company's common stock "short".

11. All loans to directors and officers of the Company are in compliance with FRB Regulation O.

Market Area and Competition

Market Area. The Bank is a community-oriented financial institution that originates residential, multifamily, construction, land, commercial real estate, consumer, and commercial business loans within its primary market area in Central California surrounding Monterey Bay. In addition, the Bank originates primarily income property and construction loans through its Los Angeles loan production office, participates in construction and income property lending with other California based community and correspondent banks, and purchases loans secured by real estate generally located between San Francisco Bay Area and San Diego as a means of geographically diversifying its loan portfolio and in conjunction with its asset / liability management program. The Company conducts only limited business north of the San Francisco Bay Area and east of the Central Valley of California. The Company conducts only a minor volume of business outside the State of California.

The economy in the Company's primary market areas in Santa Cruz, Monterey, and Santa Clara Counties has historically been primarily agricultural. However, in recent years, other economic segments have assumed a larger portion of total business activity, caused in part by the continuing southward expansion of the San Francisco Bay Area. These newer and in some cases relatively rapidly expanding segments include:

- an increasing professional presence, both in commercial property and in residential housing, as technology related companies have expanded southward, primarily down the Highway 101 corridor
- light manufacturing, taking advantage of the availability of land and pro-business orientation of certain cities
- post-secondary education
- tourism and marine biology, especially in the coastal communities on Monterey Bay
- residential construction, supported by the historically low interest rate environment of the past 18 months and by the lower cost of land versus much of the San Francisco Bay Area

The Company's primary market areas were adversely impacted during 2002 by:

- the limited pace of national economic expansion
- an increase in local unemployment rates, particularly in Santa Clara County

- the difficulties experienced by the technology industry following the significant reduction in the NASDAQ Index in recent years, constrained investment by businesses, and limited availability of venture capital financing

- weakness in the telecommunications industry

- concerns over the potential effects of a record budget deficit by the State of California

- the potential ongoing impact of and possible resolution of issues stemming from the 2001 California energy crisis, including what monies the State might be able to recoup from energy suppliers and the potential emergence from bankruptcy status by the largest energy utilities in the State

- the impacts of consumer reactions to the threats of possible future terrorist activity and geopolitical issues, especially as reflected in reduced travel and tourism, which has a particular negative effect upon the hospitality industry

To the extent that the State of California fiscal situation continues to affect the State's budget, spending, and potential level and manner of taxation, the Company will continue to be impacted.

Supported by historically low interest rates, a growing population, and limited supply in certain markets, residential real estate values in many of the communities served by the Company were steady to slightly increasing in 2002, with the notable exception of very high end residential properties ($1.5 million and above). While the Company does serve the high end real estate market by virtue of its presence in various higher cost communities along the Monterey Bay, the Company does not target this market.

Despite a general rise in foreclosure activity in California during 2002, the Company had only one foreclosure, on a single residential property, in 2002.

Throughout 2002, many large national corporations with operations in Northern and Central California announced significant layoffs. In addition, many local technology companies shut down due to a combination of weak (or negative) earnings, limited liquidity, or a lack of access to additional capital. Unemployment in the Company's market areas increased in 2002, with a particular concentration among technology and telecommunications industry workers in the Silicon Valley area of the South San Francisco Bay Area.

During 2002, the local and State economy, and the State's level of income tax receipts, did not materially benefit from a significant rise in stock and stock option wealth among individuals. This situation contrasts significantly to the impacts of a rising stock market in 1999 and early 2000.

Lease rates for many types of commercial real estate declined significantly in the San Francisco Bay Area during 2001 and 2002, reversing strong rises in 1999 and early 2000 fueled by the technology industry and Internet boom. Vacancy rates for commercial real estate generally rose in 2002, with particularly large rises in areas that served the technology boom of the late 1990's. Vacancy rates for Class A commercial real estate in downtown San Francisco were reported at nearly 20.0% at the end of 2002. While the Company originates and purchases commercial real estate loans in the San Francisco Bay Area, Management did not generally pursue loans based upon the high lease rates and market values during 1998 through 2000. The Company had no classified loans

at December 31, 2002 that were secured by commercial real estate in the San Francisco Bay Area.

Vacancy rates increased and average effective room rates declined for California hotels and motels in 2001, with the trend worsening after the events of September 11, 2001. During 2002, the hospitality industry in the Company's primary market area improved somewhat from the results experienced during the fourth quarter of 2001, but did not generally achieve the business levels enjoyed in 1999 and 2000.

In general, the real estate markets where the Company lends in Southern California were more favorable during 2002 than the San Francisco Bay Area, as the Southern California markets did not have the high concentration of technology and telecommunication firms present in the Silicon Valley and other areas around San Francisco Bay.

The economy in some segments of the Company's primary market area remains seasonal. These segments include tourism and agriculture, both of which slow during the winter months.

Competition. The banking and financial services business in California generally, and in the Bank's market areas specifically, is highly competitive. The increasingly competitive environment is a result of many factors including, but not limited to:

- the ongoing expansion of the Internet, whereby the Bank must more frequently compete with remote entities soliciting customers in its primary market areas via web based advertising and product delivery, especially for certificates of deposit and residential mortgages

- the significant consolidation among financial institutions which has occurred over the past several years, resulting in a number of substantially larger competitors with greater resources than the Company

- the increasing integration among commercial banks, insurance companies, securities brokers, and investment banks

- the continued growth and market share of non-bank financial services providers that often specialize in a single product line such as credit cards or residential mortgages

- the introduction of new technologies which may bypass the traditional banking system for funds settlement

- the addition of financial services oriented subsidiaries by firms not historically in the banking business, but with significant consumer reach

- the continued tax relief enjoyed by credit unions in serving the consumer market combined with a trend toward loosening restrictions on credit union activities and requirements for credit union membership

The Company competes for loans, deposits, fee based products, and customers for financial services with commercial banks, savings and loans, credit unions, thrift and loans, mortgage bankers, securities and brokerage companies, insurance firms, finance companies, mutual funds, and other non-bank financial services providers. Many of these competitors are much larger than the Company in total assets, market reach, and capitalization; and enjoy greater access to capital markets and can offer a broader array of products and services than the Company presently markets.

Two banks, each with several billion dollars in assets and more diversified revenue sources, present particular competition to the Company. Both these banks follow the "super community banking" business model, whereby multiple community banks are owned and operated under a unified umbrella organization. Both of these firms have expanded rapidly in recent years and have acquired community banks in the Company's primary market areas. These firms have access to far greater amounts of capital than the Company. These firms also benefit from greater economies of scale than the Company. Acquisitions by these two banks have resulted in the Company's being the largest truly local financial institution in many of its markets.

The Company also competes increasingly frequently with another community bank, which has over the past two years opened de novo offices in some of the same communities served by the Company. Additionally, in 2002, the Company experienced particular competition for retail deposits from the two largest thrifts that operate in California. These large thrifts benefited from the declining interest rate environment, with expanding net interest margins resulting from their net liability sensitivity. These thrifts used their expanding margins to bid up retail deposit rates, particularly for certain transaction accounts, in an effort to build market share.

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In order to compete with other financial services providers, the Company relies upon:

- local community involvement, contributions, and visibility
- personal service and the resulting personal relationships of its staff and customers
- referrals from satisfied customers, employees, and directors
- the development and sale of specialized products and services tailored to meet its customers' needs
- local and fast decision making

In addition, Management considers the Company's reputation for financial strength and competitive services, as developed over 77 years of local Company history, as a competitive advantage in attracting and retaining customers within its primary market area.

Risk Factors That May Affect Future Results

The following discusses certain factors that may affect the Company's financial results and operations and should be considered in evaluating the Company. The two general categories of greatest risk faced by the Company are credit risk and interest rate risk, both of which are inherent to community banking.

Ability Of The Company To Execute Its Business Strategy. The financial performance and profitability of the Company will depend, in large part, on its ability to favorably execute its business strategy in converting from a savings & loan into a community based financial services firm. This evolution entails risks in, among other areas, technology implementation, market segmentation, brand identification, banking operations, and capital and human resource investments. Accordingly, there can be no assurance that the Company will be successful in its business strategy.

Economic Conditions And Geographic Concentration. The Company's operations are located in California and are concentrated in Santa Cruz, Monterey, and Santa Clara Counties. Although Management has diversified the Company's loan portfolio into other California counties, the majority of the Company's credits remain concentrated in the three primary counties. As a result of this geographic concentration, the Company's results depend largely upon economic and real estate market conditions in these areas. Deterioration in economic or real estate market conditions in the Company's primary market areas could have a material adverse impact on the quality of the Company's loan portfolio, the demand for its products and services, and its financial condition and results of operations. In addition, because the Company does not require earthquake insurance in conjunction with its real estate lending, an earthquake with an epicenter in or near the Company's primary market areas could also significantly adversely impact the Company's financial condition and results of operations.

Interest Rates. By nature, all financial institutions are impacted by changing interest rates, due to the impact of such upon:

- the demand for new loans
- prepayment speeds experienced on various asset classes, particularly mortgage backed securities and residential loans
- credit profiles of existing borrowers
- rates received on loans and securities
- rates paid on deposits and borrowings

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As presented under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and under "Item 7a. Quantitative and Qualitative Disclosure of Market Risk", the Company is financially exposed to parallel shifts in general market interest rates, changes in the relative pricing of the term structure of general market interest rates, and relative credit spreads. Therefore, significant fluctuations in interest rates may present an adverse effect upon the Company's financial condition and results of operations.

Government Regulation And Monetary Policy. The financial services industry is subject to extensive federal and state supervision and regulation. Significant new laws, changes in existing laws, or repeals of present laws could cause the Company's financial results to materially differ from past results. Further, federal monetary policy, particularly as implemented through the Board of Governors of the Federal Reserve System, significantly affects credit conditions for the Company, and a material change in these conditions could present an adverse impact on the Company's financial condition and results of operations.

Competition. The financial services business in the Company's market areas is highly competitive, and is becoming more so due to technological advances (particularly Internet-based financial services delivery), changes in the regulatory environment, and the significant consolidation that has occurred among financial services providers. Many of the Company's competitors are much larger in total assets and market capitalization, enjoy greater liquidity in their equity securities, have greater access to capital and funding, and offer a broader array of financial products and services. In light of this environment, there can be no assurance that the Company will be able to compete effectively.

The results of the Company may materially differ in future periods depending upon the nature or level of competition.

Credit Quality. A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors, and related parties may fail to perform in accordance with the terms of their loans. The Company has adopted underwriting and credit monitoring procedures and credit policies, including the establishment and review of the allowance for loan losses, that Management believes are appropriate to control this risk by assessing the likelihood of non performance, tracking loan performance, and diversifying the credit portfolio. Such policies and procedures may not, however, prevent unexpected losses that could have a material adverse effect on the Company's financial condition or results of operations. Unexpected losses may arise from a wide variety of specific or systemic factors, many of which are beyond the Company's ability to predict, influence, and control.

State Of California Budget Crisis. The State of California is currently facing a substantial budget deficit. A combination of reductions in State provided services and increases in the level and nature of taxation might result, which could present an unfavorable impact upon the Company's business, financial condition, and results of operations. At December 31, 2002, the State of California maintained $28.0 million in deposits with the Company. If the State were to withdraw these deposits, replacement funding would likely be more expensive.

Technology Industry And Technological Change. The pace of economic activity, the demand and pay rates for labor, and real estate valuations in many of the Company's primary market areas are impacted by the technology industry. A prolonged slowdown in the technology business would therefore likely have an adverse impact on the Company's financial condition and results of operations. New products and delivery mechanisms being developed as a result of new technologies present the potential for bypassing the historic bank payments settlement process. As such, the Company is exposed to various associated financial risks.

Terrorism And The War On Terrorism. Tourism constitutes a significant component of the economy in the Company's primary market areas. In addition, the Company maintains a concentration of loans extended to the hospitality industry. Should new terrorist actions or the continued war on terrorism continue to or more dramatically curtail travel and tourism, the Company's financial condition and results of operations could be significantly impacted.

Other Risks. From time to time, the Company details other risks with respect to its business and financial results in its filings with the Securities and Exchange Commission.

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Lending Activities

General. The Company originates a wide variety of loan products. Loans originated by the Company are subject to federal and state laws and regulations. Interest rates charged by the Company on loans are affected by the demand for such loans and the supply of money available for lending purposes and the rates offered by competitors. These factors are, in turn, affected by, among other things, economic conditions, monetary policies of the federal government, including the Federal Reserve Board, and legislative tax policies. The Company targets certain lending toward low to moderate income borrowers as part of its commitment to serve its local communities.

At December 31, 2002, the Company's net loan portfolio held for

investment totaled $521.9 million. This represented the highest total in the Company's history. The vast majority of this portfolio was associated with real estate of various types. Lending activity in 2002 was supported by an active mortgage refinance market, spurred by the historically low level of interest rates following rate cuts implemented by the Federal Reserve during 2001 and 2002.

Net loans as a percentage of total assets decreased slightly from 86.8% at December 31, 2001 to 85.9% at December 31, 2002 primarily due to the Company's purchase of $9.0 million in bank owned life insurance during 2002. Allocating a greater percentage of its total assets to loans is fundamental to the Company's strategies of effectively supporting the financing needs of its local communities, increasing its net interest margin, and effectively leveraging the Company's capital position.

The Company accepts loan applications generated through brokers for most of its product line. Broker referred loans are underwritten in the same manner as direct originations. The Company encourages its employees and directors to refer and solicit loan business as an integral part of functioning as a community bank. Employees receive various types of awards or commissions based upon the volume and nature of business booked.

In purchasing individual loans or pools of loans, the Company underwrites each loan in a manner similar to its internal originations. The Company generally purchases income property loans on a servicing released basis in order to facilitate more effective credit management and in order to acquaint such borrowers with the other products and services offered by the Company. The residential mortgages purchased in 2002 were servicing retained by the seller.

The Company also pursues acquiring loan participations from and selling loan participations to other California community banks and other financial institutions. In acquiring participations, the Company underwrites each credit in a manner similar to that followed for its own internal loan production. The Company sells loan participations in order to diversify its credit risk and in order to remain below its regulatory limitation for loans to one borrower. In general, most of the Company's loan participations are for construction loans.

The Company requires title and hazard (fire, and, if applicable, flood) insurance for all real estate loans. The Company does not require earthquake insurance for real estate loans. More detailed information regarding the Company's lending activity is included in the following paragraphs that present activity by loan product category.

Residential One To Four Unit Mortgage Lending. The Company originates fixed rate, adjustable rate, and hybrid (fixed for a period, and then adjustable) mortgage loans secured by one to four family residential properties. Adjustable rate mortgage loans have interest rates that adjust monthly, semiannually, or annually and reprice based upon various indices, primarily the US Treasury One Year Constant Maturities Index ("1 Year CMT") or the MTA index, which is equivalent to the twelve month rolling average of the 1 Year CMT index. The MTA index is utilized by a number of the Company's primary competitors and is often preferred by consumers due to its limited volatility relative to the 1 Year CMT index. The Company ceased originating loans tied to the 11th District Cost of Funds ("COFI") Index in 2002. COFI is now comprised of funding results from just 41 financial institutions and is dominated by the results and actions of a small number of very large thrifts. In 2002, the Company purchased hybrid residential loans based upon the 1 Year LIBOR Index as a means of diversifying the index basis of its loan portfolio and in conjunction with its balance sheet management strategy. The Company's hybrid and adjustable rate residential mortgages typically contain various periodic and lifetime rate caps, and also lifetime rate floors. The Company regularly adjusts its loan products to meet changing customer needs and to respond to the marketplace.

By the end of 2002, the Company was selling the majority of its residential loan production into the secondary market on a servicing released basis in order to retain a greater volume of higher yielding and more interest rate sensitive loans on its balance sheet, as part of the Company's asset / liability management strategy, and also as a means of increasing non-interest income. The sales are generally on a servicing released basis because the Company believes the servicing is more valuable to high volume, low marginal cost servicers.

The majority of loan originations are to existing or past customers and members of the Bank's local communities. The Company also originates one to four family residential construction loans for both owner occupants and developers / contractors ("speculative construction loans"), and residential mortgages secured by non-owner occupied one to four family properties acquired as an investment by the borrower. The Company provides escrow (impounds) services as requested by its customers and generally for those loans in excess of 80.0% loan to value.

At December 31, 2002, the Company maintained $187.5 million in residential permanent mortgages, representing 33.1% of gross loans held for investment. This compares to $204.8 million in permanent residential mortgages a year earlier, which then constituted 42.2% of gross loans held for investment.

The majority of the residential loans at December 31, 2002 were secured by properties located within the Company's primary market area in Central California. At December 31, 2002, 6.5% of the Company's one to four family mortgage loans held for investment had fixed terms and 93.5% had adjustable rates, including adjustable rate loans that have a fixed rate for an initial period. The Company offers a variety of adjustable rate residential loan products, including an "easy qualifier" loan with more limited documentation required than other mortgages. The Company began originating loans subject to negative amortization in 1996. Negative amortization involves a greater risk to the Company because during a period of high interest rates the loan principal may increase above the amount originally advanced. However, the Company believes that the risk of default on these loans is mitigated somewhat by negative amortization caps, underwriting criteria, relatively low loan to value ratios, and the stability provided by payment schedules. At December 31, 2002, the Company's residential loan portfolio included $19.9 million of loans subject to negative amortization.

The Company originates one to four family residential mortgage loans in amounts up to 80% of the lower of the appraised value or the selling price of the property securing the loan, and up to 97% of the appraised value or selling price if private mortgage insurance is obtained. Mortgage loans originated by the Company generally include due on sale clauses which provide the Company with the contractual right to deem the loan immediately due and payable in the event the borrower transfers ownership of the property without the Company's consent. Due on sale clauses are an important means of adjusting the rates on the Company's mortgage loan portfolio and the Company has generally exercised its rights under these clauses.

The five largest residential loans in the Company's portfolio at December 31, 2002 are presented in the following table. Original loan to value ratio equals the loan's original principal balance divided by the original appraisal amount obtained at the time of loan origination. Current loan to value ratio equals the December 31, 2002 principal balance divided by the original appraisal amount obtained at the time of loan origination.

(Dollars In Thousands)

Principal Balance Outstanding	Year Of Origination / Acquisition	Property Location	Original Loan To Value Ratio
$ 3,088	2000	Carmel Valley, California	50%
$ 2,500	2002	Monterey, California	71%
$ 2,493	2002	Pleasanton, California	61%
$ 2,006	2000	Pebble Beach, California	70%
$ 1,785	2002	Rancho Santa Fe, California	39%

* Loan product permitting negative amortization

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Multifamily Lending. The Company offers hybrid and adjustable rate permanent multifamily (five or more units) real estate loans secured by real property in California. The Company also periodically extends construction financing to builders of multifamily housing. From time to time, the Company extends loans secured by mixed use property in more urban areas, which typically present commercial (generally retail) space in one part of the building (often street level) and residential units in other parts of the building.

Multifamily property valuations have generally increased in California during the past several years, as supply has not expanded with the same speed as population growth, with property values further enhanced by low financing rates and reduced competition from other forms of investment. Apartment market rents and vacancies during 2002 varied by local market conditions, with the strongest performance in various Southern California communities and the softest market conditions in the greater San Jose area. Apartment rent levels in the Central Coast area during 2002 were generally stable to rising, supported by limited new supply. Multifamily property valuations are impacted by local rent control ordinances, which are administered in a number of California communities.

Permanent loans on multifamily properties typically present maturities of up to 30 years. Factors considered by the Company in reaching a lending decision on such properties include the net operating income of the mortgaged premises before debt service and depreciation, the debt service ratio (the ratio of net earnings to debt service), the ratio of the loan amount to appraised value, and the financial profile of any guarantors. Pursuant to the Company's underwriting policies, multifamily hybrid and adjustable rate mortgage loans are generally originated in amounts up to 75% of the appraised value of the underlying properties. The Company generally requires a debt service ratio of at least 1.10. Properties securing loans are appraised by an independent appraiser. Title insurance is required on all loans.

When evaluating the qualifications of the borrower for a multifamily loan, the Company considers the financial resources and income level of the borrower, the borrower's experience in owning or managing similar property, and the Company's lending experience with the borrower. The Company's underwriting policies require that the borrower provide evidence of ability to repay the mortgage on a timely basis and maintain the property from current rental income. In evaluating the creditworthiness of the borrower, the Company generally reviews the borrower's financial statements, employment, tax returns, and credit

history, as well as other related documentation.

Loans secured by apartment buildings and other multifamily residential properties are generally larger and involve a greater degree of risk than one to four family residential loans. Because payments on loans secured by multifamily properties are often dependent on successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. The Company seeks to mitigate these risks through its underwriting policies, which require such loans to be qualified at origination on the basis of the property's income and debt coverage ratio. The Company also attempts to limit its risk exposure by requiring annual operating statements on the properties and by acquiring personal guarantees from the borrowers when available.

There is a limited volume of multifamily properties in the Company's primary market area due to the more rural aspects of many local communities. Therefore, in conjunction with its business strategy, the Company in 2003 intends to continue increasing its multifamily real estate lending within the State of California. At December 31, 2002, the Company's portfolio of multifamily loans totaled $118.0 million, or 20.8% of gross loans receivable held for investment. This compares to $103.9 million, or 21.4% of gross loans receivable held for investment, at December 31, 2001. The Company acquired multifamily loans from direct originations, broker referrals, and individual loan purchases during 2002. It is expected that all of these sources will be utilized in 2003.

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The five largest multifamily real estate loans in the Company's portfolio at December 31, 2002 are presented in the following table:

(Dollars In Thousands)

Principal Balance Outstanding	Year Of Origination / Acquisition	Property Location	Original Loan To Value Ratio
$ 3,822	2001	Van Nuys, California	64%
$ 2,561	2002	Westminster, California	75%
$ 2,472	2002	San Francisco, California	66%
$ 2,470	2001	West Hollywood, California	74%
$ 2,271	2001	Oakland, California	74%

Because the primary marketplace the Company serves has a limited volume of multifamily properties, the Company intends to continue pursuing multifamily real estate loans secured by properties located throughout California. The Company's strategy in this regard includes purchasing participations in multifamily loans originated by experienced, local lenders with a favorable record of quality loan origination. The acquisition and origination of multifamily loans throughout California presents the Company with geographic diversification, but also introduces credit exposure due to the greater demands of monitoring the demand for and value of multifamily real estate in a greater number of market areas.

Commercial & Industrial Real Estate Lending. The Company originates both permanent and construction loans secured by commercial & industrial real estate located in California. The Company's underwriting procedures provide that

commercial & industrial real estate loans may generally be made in amounts up to the lesser of 65% of the appraised value of the property or up to a debt service coverage ratio of 1.20. The Company occasionally extends commercial & industrial real estate loans with an initial loan to value ratio in excess of 65.0% based upon the nature of the property and the financial strength of the borrowers and guarantors. Permanent loans may be made with terms up to 25 years and are typically hybrid (fixed for three to five years, then adjustable) or adjustable based upon the 1 Year CMT Index. The Company's underwriting standards and credit review procedures on commercial & industrial real estate loans are similar to those applicable to multifamily loans. The Company considers the property's net operating income, the loan to value ratio, the presence of guarantees, and the borrower's expertise, credit history, and financial status.

The Company's commercial & industrial real estate loans are typically secured by properties such as retail stores, retail strip centers, office buildings, and light manufacturing facilities. The Company typically does not extend loans for the acquisition or refinance of major manufacturing facilities, as that type of real estate generally encompasses larger loans than the Company makes. The Company generally avoids originating or purchasing commercial & industrial real estate loans secured by unique or single use buildings, such as theatres or bowling alleys. The Company also takes various steps to attempt to avoid extending loans secured by commercial & industrial real estate that presents significant environmental issues, such as groundwater contamination or the presence of toxic chemicals. However, despite these steps, including environmental reviews, there can be no assurance that the Company can avoid financial exposure resulting from environmental issues associated with loan collateral.

The majority of the commercial & industrial real estate loans are secured by property located in Northern and Central California. However, the Company has in the past several years pursued participations on and purchases of commercial & industrial real estate loans with experienced, local lenders in the greater San Diego and Los Angeles markets as a means of increasing loans outstanding and geographically diversifying the Company's loan portfolio.

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At December 31, 2002, the Company's permanent commercial & industrial real estate loan portfolio totaled $140.0 million, or 24.7% of gross loans held for investment. This compares to $110.0 million, or 22.7% of gross loans held for investment, at December 31, 2001. This nominal expansion is consistent with the Company's business strategies of:

- increasing the percentage of its balance sheet represented by income property loans

- meeting the real estate and business financing needs of businesses and individuals whose business is domiciled in real estate owned by the borrower

- seeking comprehensive relationships with businesses in the Company's primary market areas, including the placement of deposits with the Company and the Company's provision of funds transfer services

The five largest commercial & industrial real estate loans in the Company's portfolio at December 31, 2002 are presented in the following table:

(Dollars In Thousands)

Principal Balance Outstanding	Year Of Origination / Acquisition	Type Of Property	Property Location
$ 4,905	2002	Retail	Los Angeles, California
$ 3,794	2002	Retail	Long Beach, California
$ 3,745	2002	General Office	Santa Monica, California
$ 3,321	2001	Mini-Storage Facility	San Jose, California
$ 2,992	2002	Motel	Monterey, California

At December 31, 2002, the Company had $29.0 million in outstanding loans secured by hotel / motel properties. None of these loans were construction loans. The Company continues to actively monitor these loans, as the hospitality industry has been particularly impacted by the weak pace of national economic growth, reduced business travel, and a general slowdown in tourism and recreational travel versus the levels experienced in 1999 and 2000.

Loans secured by commercial & industrial real estate properties, like multifamily loans, are generally larger and involve a greater degree of risk than one to four family residential mortgage loans. Because payments on loans secured by commercial real estate properties are often dependent on successful operation or management of the properties, repayment of such loans may be significantly subject to adverse conditions in the properties' management or real estate markets in general or particular to a subject property. The Company seeks to mitigate these risks through its underwriting standards and credit review policy, which requires annual operating statements for each collateral property. The Company also participates larger commercial & industrial real estate loans with other financial institutions as a means of diversifying its credit risk and remaining below the Bank's regulatory limit on loans to one borrower.

Commercial & industrial real estate loans can present various environmental risks, as such properties are sometimes located on sites or in areas where various types of pollution may have historically occurred. The Company takes various steps to attempt to avoid extending loans secured by commercial & industrial real estate that presents significant environmental issues, such as groundwater contamination or the presence of toxic chemicals. However, despite these steps, there can be no assurance that the Company can avoid financial exposure resulting from environmental issues associated with loan collateral. The Company attempts to mitigate environmental risk via surveys, reports, and, in some cases, testing; in addition to using a limited list of pre-approved appraisers. In addition, Company lending staff directly inspect most commercial & industrial real estate properties on which the Company lends.

Commercial & industrial real estate can also be impacted by changing government regulation, with a potential associated impact on the market value of the collateral securing the Company's loans.

Construction Lending. The Company originates construction loans for the acquisition and development of property. Collateral has been historically concentrated in residential properties, both owner occupied and speculative (i.e. not being built by an owner occupant, but perhaps pre-sold to third parties). In addition, the Company makes construction loans for the development and rehabilitation of apartments and commercial buildings.

Construction financing is generally considered to involve a higher degree of risk than long-term financing on improved, occupied real estate. The Company's risk of loss on construction loans depends largely upon:

- the accuracy of the initial estimate of the property's value at completion of construction or development
- the accuracy of the estimated cost of construction
- the borrower's ability to complete the construction project within estimated timeframes
- the market demand for the subject property at the completion of construction
- the ability of tenants, if any, to honor lease obligations for the subject property
- the availability of permanent financing for the subject property at the conclusion of the construction period

If the estimate of construction costs proves to be inaccurate, the Company may have to advance funds beyond the amount originally committed to permit completion of the project and to protect its security position. The Company may also be confronted, at or prior to maturity of the loan, with a project with insufficient value to ensure full repayment. The Company's underwriting, monitoring, and disbursement practices with respect to construction financing are intended to ensure that sufficient funds are available to complete construction projects. The Company attempts to limit its risk through its underwriting procedures, by using only approved appraisers, and by dealing with qualified builders / borrowers. The Company also participates larger construction loans with other financial institutions as a means of diversifying its credit risk and remaining below the Bank's regulatory limit on loans to one borrower.

The Company's construction loans typically have adjustable rates and terms of 12 to 18 months. The Company originates one to four family and multifamily residential construction loans in amounts up to 80% of the appraised value of the property. Land development loans are determined on an individual basis, but in general they do not exceed 70% of the actual cost or current appraised value of the property, whichever is less. Loan proceeds are disbursed in increments as construction progresses and as construction site inspections warrant.

At December 31, 2002, the Company had gross construction and land development loans totaling $69.5 million, on which there were undisbursed loan funds of $36.7 million. At December 31, 2001, the Company had gross construction and land development loans totaling $38.5 million, on which there were undisbursed loan funds of $12.6 million. The gross balance of construction loans as a percentage of gross loans held for investment thus increased from 7.9% at December 31, 2001 to 12.3% at December 31, 2002.

The increase in construction loans during 2002 was in conformity with the strategic business plan and was fostered by borrower relationships serviced through the Los Angeles loan production office. The Company has strategically targeted increased construction lending because of the interest rate sensitivity of the loans, the Company's experience in this type of lending, the yields available from this type of lending, and, in the case of owner residential construction loans, the strong customer bond developed in financing the building of someone's home.

The five largest construction loans in the Company's portfolio at December 31, 2002 are presented in the following table:

(Dollars In Thousands)

Construction Commitment Amount	Year Of Origination / Acquisition	Type Of Construction	Property Location
$ 7,500	2002	Apartment Building	Los Angeles, California
$ 6,950	2002	Residential Development	Soledad, California
$ 6,100	2002	Light Industrial	Watsonville, California
$ 3,708	2000	Light Industrial	Fremont, California
$ 3,605	2002	Retail	Riverside, California

The light industrial construction project located in Fremont presented in the above table was in the process of being subdivided from one large real estate project into individual buildings and parcels at December 31, 2002. This change, in addition to soft market conditions, contributed to the delay in finalizing the construction project. The borrowers present significant financial resources and the loan was current in its payments at December 31, 2002.

Because construction loans are generally larger and more complex than typical residential mortgages, they present a greater degree of credit risk. The Company attempts to control this credit risk through its underwriting and funds disbursement processes. In addition, it is the Company's strategy to, over time, build a series of strong relationships with local developers / builders / contractors with whom the Company has detailed financial knowledge and receives a steady stream of repeat business.

Land Lending. The Company offers loans secured by land, generally located in its immediate marketplace. The types of land generally considered by the Company are suitable for residential development or are demarcated residential lots. The Company does not extend loans on agricultural land where repayment of the loan is dependent upon crop sales.

At December 31, 2002, land loans totaled $24.8 million, or 4.4% of gross loans held for investment. This compares to land loans totaling $11.9 million, or 2.5% of gross loans held for investment, at December 31, 2001.

The five largest land loans in the Company's portfolio at December 31, 2002 are presented in the following table. These five loans constituted almost 34.0% of the Company's total portfolio of land loans, as measured by principal balance, at December 31, 2002.

(Dollars In Thousands)

Principal Balance Outstanding	Year Of Origination / Acquisition	Type Of Land	Property Location

$ 2,275	2002	Residential Lots	Santa Monica, California
$ 2,080	2002	Commercial	Burbank, California
$ 1,500	2001	Residential Lots	Monterey, California
$ 1,319	2001	Residential Lots	Los Gatos, California
$ 1,268	2002	Residential Lots	West Hollywood, California

The land loan in the above table secured by the West Hollywood lots was paid off in full in early 2003.

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Because land and lots are generally less readily marketable than residential real estate, lending on land presents additional risks not present in residential mortgages. The market value of land and lots can be more susceptible to changes in interest rates, economic conditions, or local real estate markets than the market value for homes. Zoning changes by various government authorities may also impact the value and marketability of certain types of land. To mitigate these risks, the Company generally requires lower loan to value ratios and shorter contractual terms for land and lot loans. The $2.1 million loan secured by commercial land presented in the above table was originated with a 75.0% loan to value ratio because the borrower is a real estate professional well known to the Company. This borrower has substantial financial resources and personally guaranteed the loan. The loan is planned to be repaid in 2003 through a construction loan to build an office building that has been pre-leased.

Commercial Business Lending. The Company offers a wide variety of commercial business loans, both in the form of lines of credit and amortizing term loans. Commercial business loans are extended for accounts receivable financing, inventory acquisition, equipment purchase, and business expansion, among other purposes.

The majority of the Company's business loans are collateralized by business assets. Such collateral is typically comprised of accounts receivable, inventory, and / or equipment. In addition, the Company frequently obtains a deed of trust on real estate as additional collateral for certain business loans and generally pursues personal guarantees from principals of closely held businesses. Commercial lending is generally considered to involve a higher degree of risk than the financing of real estate, primarily because security interests in the collateral are more difficult to perfect and the collateral may be difficult to obtain or liquidate at desirable values following an uncured default. Commercial business loans typically offer relatively higher yields, short maturities, and variable interest rates. The availability of such loans enables existing and potential business depositors to establish a more complete financial relationship with the Company.

For closely held businesses, the Company pursues a marketing objective of obtaining both the personal and commercial banking business from the principals. The Company believes that multiple benefits arise from establishing strong relationships with and thoroughly understanding customers. These benefits include the ability to offer more proactive and effective financial solutions and the opportunity to mitigate credit losses through the timely receipt of key information.

The Company attempts to reduce the risk of loss associated with business lending by closely monitoring the financial condition and performance of its customers. Each business loan customer is assigned to a commercial banking relationship officer. The relationship officer is responsible for

monitoring the financial condition of the borrower, developing solutions to the financial needs of the customer, facilitating the growth of the customer's business, and expanding the customer's overall business relationship with the Company. The Company's business strategy envisions commercial business loans representing a greater percentage of total assets in the future.

The Company also attempts to mitigate the risk inherent in commercial business lending by having third parties review the credits on a periodic basis and by engaging specialists to audit the collateral, including accounts receivable, of the business. In 2003, the Company plans to participate larger commercial business loans with other community banks as a means of diversifying credit risk and remaining below the Bank's regulatory limit on loans to one borrower. The Company also intends to seek similar participations from other California community banks.

At December 31, 2002, the Company had commercial business term loans totaling $5.2 million and drawn balances against commercial lines of credit totaling $12.8 million. In the aggregate, commercial business loans comprised 3.2% of gross loans held for investment at December 31, 2002. In comparison, the Company had a total of $8.8 million in commercial business loans outstanding at December 31, 2001, representing 1.8% of gross loans held for investment.

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The five largest commercial business loans in the Company's portfolio at December 31, 2002 are presented in the following table:

(Dollars In Thousands)

Line Of Credit Commitment Amount	Year Of Origination / Acquisition	Type Of Business	Business Location
$ 2,000	2001	Semiconductor Equipment	Scotts Valley, Calif
$ 2,000	2002	Photographic Equipment	Watsonville, Califor
$ 1,600	2002	Wholesale Produce Distribution	Watsonville, Califor
$ 1,000	2002	Retail	Monterey, California
$ 1,000	2001	Industrial Gases	Watsonville, Califor

All of the above commercial business loans are associated with firms in the Company's primary market area.

Loan Approval Procedures And Authority. The Board of Directors has ultimate responsibility for the lending activity of the Company and establishes the lending policies of the Company, including the appraisal policy and credit approval authorities. The Board of Directors also approves all appraisers used by the Company. As of December 31, 2002, the Board of Directors has authorized the following loan approval authorities:

Real Estate Loans

(1) Residential mortgage loans in amounts up to the federal agency (e.g. Federal National Mortgage Association or "FNMA") conforming limit may be approved by the Company's staff underwriters.

(2) Loans in excess of the agency conforming limits and up to $500,000 may be approved by the underwriting / processing manager.

(3) Loans in excess of $500,000 and up to $1,000,000 require the approval of the Chief Executive Officer / President, Chief Loan Officer, or the Director of Commercial Banking.

(4) Loans in excess of $1,000,000 and up to $2,000,000 require the approval of two of the Chief Executive Officer / President, Chief Loan Officer, or Director of Commercial Banking.

(5) Loans in excess of $2,000,000 require the approval of the Board of Directors Loan Committee.

Non-Real Estate Loans

(1) Overdraft lines of credit of up to $1,500 require the approval of the underwriting / processing manager or the Chief Loan Officer.

(2) Loans up to $500,000 require the approval of the Chief Executive Officer / President, Chief Loan Officer, or Director of Commercial Banking.

(3) Loans in excess of $500,000 require the approval of the Board of Directors Loan Committee.

The loan origination process requires that upon receipt of a completed loan application, a credit report is obtained and certain information is verified. If necessary, additional financial information is obtained from the prospective borrower. An appraisal of the related real estate is performed by an independent, licensed appraiser. If the original loan exceeds 80% loan to value on a first trust deed loan or private mortgage insurance is required, the borrower is required to make payments to a loan impound account from which the Company makes disbursements for property taxes and insurance.

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Loan Portfolio Composition. The following table presents the composition of the Company's net loans receivable held for investment at the dates indicated.

	At December 31,						
	2002		2001		2000		
	Amount	%	Amount	%	Amount	%	Amo
					(Dollars In Thousands)		
Real estate loans							
Residential one to four unit	$187,471	33.1%	$204,829	42.2%	$160,155	37.8%	$168
Multifamily five or more units	118,004	20.8%	103,854	21.4%	76,727	18.1%	42
Commercial and industrial	140,027	24.7%	109,988	22.7%	102,322	24.1%	72
Construction	69,526	12.3%	38,522	7.9%	59,052	13.9%	79
Land	24,801	4.4%	11,924	2.5%	16,310	3.9%	13

Sub-total real estate loans	539,829	95.3%	469,117	96.7%	414,566	97.8%	375
Other loans							
Home equity lines of credit	8,779	1.5%	6,608	1.4%	5,631	1.3%	3
Other consumer loans	437	0.1%	372	0.1%	669	0.2%	
Commercial term loans	5,231	0.9%	3,163	0.6%	1,641	0.4%	6
Commercial lines of credit	12,777	2.2%	5,680	1.2%	1,438	0.3%	1
Sub-total other loans	27,224	4.7%	15,823	3.3%	9,379	2.2%	12
Total gross loans held for investment	567,053	100.0%	484,940	100.0%	423,945	100.0%	388
(Less) / Plus							
Undisbursed loan funds	(36,683)		(12,621)		(26,580)		(23
Unamortized premiums & discounts	848		435		21		
Deferred loan fees, net	(1,127)		(202)		(202)		
Allowance for loan losses	(8,162)		(6,665)		(5,364)		(3
Total loans held for investment, net	$521,929		$465,887		$391,820		$ 60

Loan Maturity Profile. The following table shows the contractual maturities of the Company's gross loans held for investment at December 31, 2002.

	At December 31, 2002			
	2003	2004 Through 2007	2008 And Thereafter	Total Gross Loans
	(Dollars In Thousands)			
Residential one to four unit	$ 598	$ 2,675	$184,198	$187,471
Multifamily five or more units	4	4,646	113,354	118,004
Commercial and industrial real estate	--	16,620	123,407	140,027
Construction	34,069	35,457	--	69,526
Land	16,821	7,980	--	24,801
Home equity lines of credit	--	47	8,732	8,779
Other consumer loans	265	--	172	437
Commercial term loans	25	4,046	1,160	5,231
Commercial lines of credit	9,371	3,406	--	12,777
Total	$61,153	$74,877	$431,023	$567,053

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The following table presents the Company's gross loans held for investment at December 31, 2002, segregating those with fixed versus adjustable

interest rates and also isolating those loans with contractual maturities less than or equal to and greater than one year.

	Matures In 2003		Matures After 2003		
	Fixed	Adjustable	Fixed	Adjustable	Fi
			(Dollars In Thousands)		
Residential one to four unit	$ --	$ 598	$12,219	$174,654	$12
Multifamily five or more units	4	--	840	117,160	
Commercial and industrial real estate	--	--	8,662	131,365	8
Construction	3,112	30,957	--	35,457	3
Land	--	16,821	--	7,980	
Home equity lines of credit	--	--	--	8,779	
Other consumer loans	265	--	172	--	
Commercial term loans	--	25	481	4,725	
Commercial lines of credit	--	9,371	--	3,406	
Total	$3,381	$57,772	$22,374	$483,526	$25
Percent of gross loans outstanding held for investment	0.6%	10.2%	3.9%	85.3%	

Loan Commitments. At December 31, 2002, the Company had $39.4 million in outstanding commitments to originate loans and lines of credit, not all of which were rate locked at that time. These commitments had expiration dates or other termination clauses. Because customers do not always accept loan commitments (e.g. perhaps as a result of applying to more than one lender), the Company anticipates future cash requirements associated with these commitments to be less than the $39.4 million total.

At December 31, 2002, the Company had made available various commercial, personal, and residential lines of credit totaling $37.2 million, of which the undisbursed portion was $15.6 million. Of this $15.6 million, $9.4 million was associated with commercial business lines of credit, $5.8 million was associated with home equity lines of credit, and $0.4 million was associated with consumer overdraft lines of credit. The Company's commercial lines of credit are generally extended for terms of one year, although the Company does provide two to three year line of credit facilities in certain cases based upon the customer's business need and available collateral. The Company's home equity lines of credit generally revolve for ten years, and then amortize over the following fifteen years. For additional information regarding the Company's loan commitments, please refer to Note 15 to the Consolidated Financial Statements.

Originations, Purchases, And Sales Of Loans. The Company's mortgage lending activities are conducted primarily through Bank employees in its eight full service branch offices, construction and commercial real estate relationship officers domiciled in its Watsonville headquarters building and its Los Angeles loan production office, and approximately 60 wholesale loan brokers who deliver completed loan applications to the Company. In addition, the Company has developed correspondent relationships with a number of financial institutions to facilitate the origination and sale of real estate and commercial business loans on a participation basis. Loans presented to the Company for purchase or participation are underwritten substantially in accordance with the Company's established lending standards.

The Company plans to continue actively purchasing individual loans, loan pools, and loan participations in 2003 as a means of utilizing the Bank's strong regulatory capital position and supporting the more rapid transformation of the Company's balance sheet into that more consistent with a community commercial bank. The Company anticipates that a majority of loan purchases and loan participations in 2003 will be associated with loans collateralized by income property.

Depending on its asset / liability strategy, the Company originates one to four family residential loans for sale in the secondary market. Loan sales are dependent on the level of loan originations and the relative customer demand for mortgage loans, which is affected by the current and expected future level of interest rates. During the years ended December 31, 2002 and 2001, the Company sold $18.5 million and $11.5 million, respectively, of longer term, fixed rate residential loans. The Company generally sells its fixed rate residential loans on a servicing released basis in order to take advantage of comparatively attractive servicing premiums being offered in the secondary market. While the level and timing of any future loan sales will depend upon market opportunities and prevailing interest rates, the Company anticipates selling the vast majority of its long term, fixed rate residential loan production and residential hybrid loan originations in 2003 on a servicing released basis into the secondary market in conjunction with its asset / liability management program and in order to continue shifting its loan mix away from the historical concentration in residential mortgages.

From time to time, depending on its asset / liability and capital management strategies, the Company considers converting a portion of its mortgages into readily marketable mortgage backed securities, which can also be utilized in collateralized borrowings such as securities sold under agreements to repurchase. The Company's last such securitization occurred in 1998. Securitization is undertaken primarily to provide greater liquidity for the assets and thereby augment the Company's ability to manage its interest rate risk profile and cash flows. The Company may conduct future securitizations depending upon its asset / liability, liquidity, and capital management strategies.

Loan Servicing. The Company services its own loans as well as loans owned by others. Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, holding escrow funds for the payment of real estate taxes and insurance premiums, contacting delinquent borrowers, and supervising foreclosures and property dispositions in the event of unremedied defaults. Loan servicing income includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. At December 31, 2002, the Company was servicing $35.3 million in various types of loans for others.

The Company's strategic plan does not contain a significant expansion in its loan servicing for others, as Management believes large volume residential loan servicers enjoy economies of scale and efficiencies in this business that render it difficult for the Company to compete and generate a desirable rate of return. The significant consolidation in the residential loan servicing industry that has occurred over the past several years, in the opinion of Management, supports this position.

Credit Quality

General. Although Management believes that non-performing loans are

generally well secured and / or reserved, real estate acquired through foreclosure is properly valued, and inherent losses are provided for in the allowance for loan losses, there can be no assurance that future deterioration in local or national economic conditions, collateral values, borrowers' financial status, or other factors will not result in future credit losses and associated charges against operations. In regards to real estate acquired via foreclosure, although all such properties are actively marketed by the Company, no assurance can be provided regarding when these properties will be sold or what the terms of sale will be when they are sold. It is the Company's general policy to obtain appraisals at the time of foreclosure and to periodically obtain updated appraisals for foreclosed properties that remain unsold.

Non-accrual, Delinquent, And Restructured Loans. Management generally places loans on non-accrual status when they become 90 days past due, unless they are well secured and in the process of collection. Management also places loans on non-accrual status when they are less than 90 days delinquent when there is concern about the collection of the debt in accordance with the terms of the loan agreement. When a loan is placed on non-accrual status, any interest previously accrued but not collected is reversed from income. Loans are charged off when management determines that collection has become unlikely. Restructured loans are those where the Company has granted a concession on the interest paid, principal owed, or the original repayment terms due to financial difficulties of the borrower or because of issues with the collateral securing the loan.

Delinquent Loan Procedures. Specific delinquency procedures vary depending on the loan type and period of delinquency. However, the Company's policies generally provide that loans be reviewed at least monthly for delinquencies, and that if a borrower fails to make a required payment when due, the Company institutes internal collection procedures. For mortgage loans, written late charge notices are mailed no later than the 15th day of delinquency. At 25 days past due, the borrower is contacted by telephone and the Company makes a verbal request for payment. At 30 days past due, the Company begins tracking the loan as a delinquency, and at 45 days past due a notice of intent to foreclose is mailed. When contact is made with the borrower prior to foreclosure, the Company generally attempts to obtain full payment or develop a repayment schedule with the borrower to avoid foreclosure.

For commercial business loans, the account relationship officer generally contacts the borrower within ten days of a delinquency. If the borrower is unable or unwilling to make contracted payments, the Company initiates collection efforts that vary by the type of commercial business loan and the nature of the collateral. If the commercial business loan is real estate secured, the Company follows collection procedures similar to those described above for mortgage loans. If the business loan is secured by inventory, equipment, or other non-real estate collateral, the Company pursues acquisition and liquidation of the pledged collateral. If the commercial business loan has a personal guarantee, the Company will contact the guarantor to honor the guarantee and make the contractual loan payments. The Company may also proceed with various forms of legal action to enforce collection of delinquent commercial business loans.

Non-performing Assets. Non-performing loans include non-accrual loans, loans 90 or more days past due and still accruing interest, and restructured loans. Non-performing assets include all non-performing loans, real estate acquired via foreclosure, and repossessed consumer assets.

Real estate acquired via foreclosure is recorded at the lower of the recorded investment in the loan or the fair value of the related asset on the

date of foreclosure, less estimated costs to sell. Fair value is defined as the consideration that a real estate asset would yield in a current sale between a willing buyer and a willing seller. Development and improvement costs relating to the property are capitalized to the extent they are deemed to be recoverable upon disposal. The carrying value of acquired property is regularly evaluated and, if appropriate, an allowance is established to reduce the carrying value to fair value less estimated costs to sell. The Company typically obtains appraisals on real estate acquired through foreclosure at the time of foreclosure, and generally conducts inspections on foreclosed properties on a quarterly basis.

The following table presents information regarding non-performing assets at the dates indicated.

	At December 31,				
	2002	2001	2000	1999	1
	(Dollars In Thousands)				
Outstanding Balances Before Valuation Reserves					
Non-accrual loans	$2,643	$2,252	$4,666	$6,888	$1
Loans 90 or more days delinquent and accruing interest	--	--	--	--	
Restructured loans in compliance with modified terms	--	--	75	1,294	1
Total gross non-performing loans	2,643	2,252	4,741	8,182	2
Investment in foreclosed real estate before valuation reserves	846	--	--	96	
Repossessed consumer assets	--	--	--	--	
Total gross non-performing assets	$3,489	$2,252	$4,741	$8,278	$3
Gross non-performing loans to total loans	0.50%	0.48%	1.19%	2.25%	
Gross non-performing assets to total assets	0.57%	0.42%	0.98%	1.79%	
Allowance for loan losses	$8,162	$6,665	$5,364	$3,502	$2
Allowance for loan losses / non-performing loans	308.82%	295.96%	113.14%	42.80%	9
Valuation allowances for foreclosed real estate	$ --	$ --	$ --	$ --	$

Non-accrual loans increased from $2.3 million at December 31, 2001 to $2.6 million at December 31, 2002 primarily due to the placement of a $2.3 million commercial real estate mortgage on non-accrual status during the first quarter of 2002; only partially offset by payoffs and reinstatements. This $2.3 million credit is a participation loan where the Bank is not the lead financial institution. The loan is secured by a first deed of trust on a hotel / resort located within the Company's primary market area and by a first deed of trust on a residential lot located in California. The borrowers are directly personally indebted. The hotel / resort is a relatively new development that has experienced limited cash flow. The hotel / resort was also adversely impacted by the decline in tourism and travel during late 2001 and all of 2002.

At December 31, 2002, the Company maintained a $462 thousand specific reserve for this hotel / resort loan, based upon estimated net proceeds

following foreclosure and sale. Although the loan was current in its payments at December 31, 2002, the Company maintained the loan on non-accrual status at December 31, 2002 due to concern about the future net cash flow of the hotel / resort during the seasonally slow winter months, particularly in light of the status of the economy, the tourism industry, and the outlook for business travel activity. These factors also create particular volatility in the market value of the hotel / resort.

Non-accrual loans at December 31, 2002 also included:

o a residential mortgage with a principal balance of $201 thousand

o a $129 thousand loan secured by a first deed of trust on residential land

o a $49 thousand home equity line of credit

All of the Company's non-accrual loans at December 31, 2002 were graded substandard (see Criticized And Classified Assets, below). The residential mortgage with a principal balance of $201 thousand fully reinstated late in the first quarter of 2003. The Company anticipates foreclosing on the above $129 thousand non-accrual loan near the end of the first quarter of 2003. However, because of the low loan to value ratio, the Company may be paid off in full at the foreclosure sale; a likelihood reinforced by the volume of inquiries received by the Company during the first quarter of 2003.

At December 31, 2002, the Company had one foreclosed property with a book value of $846 thousand. This property is a custom single family home located in an upscale neighborhood in the East Bay of the Greater San Francisco Bay Area. The property is currently under contract for sale to close prior to the end of the first quarter of 2003 at a price that would generate a gain on sale for the Company. In addition, the Company during the first quarter of 2003 accepted a "backup" offer on the property that would generate approximately the same net proceeds.

The following table presents information concerning loans 60 to 89 days delinquent at the dates indicated.

	Loans On Accrual Status And Delinquent 60 - 89 Day			
	2002		2001	
(Dollars In Thousands)	Number Of Loans	Principal Balance	Number Of Loans	Principal Balance
Residential one to four unit	2	$ 396	1	$ 154
Other consumer loans	--	--	2	2
Total	2	$ 396	3	$ 156
60 - 89 day delinquent loans to gross loans net of undisbursed loan funds and unamortized yield adjustments		0.07%		0.03%

The following table presents information regarding non-accrual loans at the dates indicated.

(Dollars In Thousands)	Loans On Non-accrual Status At Decembe			
	2002		2001	
	Number Of Loans	Principal Balance	Number Of Loans	Principal Balance
Residential one to four unit	1	$ 201	3	$ 1,372
Commercial and industrial real estate	1	2,264	1	851
Commercial construction	--	--	--	--
Land	1	129	--	--
Home equity lines of credit	1	49	--	--
Consumer lines of credit	--	--	1	1
Commercial term loans	--	--	2	28
Total	4	$ 2,643	7	$ 2,252
Non-accrual loans to gross loans net of undisbursed loan funds and unamortized yield adjustments		0.50%		0.48%

Interest income foregone on non-accrual loans outstanding at year-end totaled $18 thousand, $46 thousand, and $110 thousand at December 31, 2002, 2001, and 2000, respectively. At December 31, 2002, the Company had no commitments to extend additional funds to loans on non-accrual status.

Criticized And Classified Assets. To measure the quality of assets, the Company has established internal asset classification guidelines as part of its credit monitoring system for identifying and reporting current and potential problem assets. Under these guidelines, both asset specific and general portfolio valuation allowances are established.

The Company currently classifies problem and potential problem assets into one of four categories, presented below in order of increasing severity.

Category	Definition
Criticized Assets	
Special Mention	Special Mention loans (sometimes referred to as "watch list" loans) possess weaknesses, but do not currently expose the Company to sufficient risk to warrant categorization as a classified asset or assignment of a specific valuation allowance. Weaknesses that might categorize a loan as Special Mention include, but are not limited to, past delinquencies or a general decline in business, real estate, or economic conditions applicable to the loan.

Classified Assets	
Substandard	Substandard loans have one or more defined weakness and are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.
Doubtful	Doubtful loans have the weaknesses of substandard loans, with the additional characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values questionable; and there is a high possibility of loss of some portion of the principal balance.
Loss	Loss loans are considered uncollectible and their continuance as an asset is not warranted.

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The Company's methodology for calculating the allowance for loan losses includes higher formula allowance factors for criticized and classified loans than for loans not adversely graded ("Pass loans"). The formula allowance factor for a given type of loan (e.g. commercial & industrial real estate loans) is progressively higher for loans graded Special Mention, Substandard, and Doubtful. These amounts represent loss allowances which have been established to recognize the inherent risk associated with these lending activities, but which, unlike specific allowances, have not been allocated to particular problem assets. Judgments regarding the adequacy of valuation allowances are based on continual evaluation of the nature, volume and quality of the loan portfolio, collateral assets, borrower financial status, and current economic conditions that may affect the recoverability of recorded amounts. Assets classified as a loss require either a specific valuation allowance equal to 100% of the amount classified or a charge-off of such amount.

The following table presents the Company's criticized and classified assets at the dates indicated:

	At December 31,		
Outstanding Balances Before Specific Valuation Allowances	2002	2001	
	(Dollars In Thousands		
Criticized Assets			
Special mention	$ 4,899	$ 6,207	$
Classified Assets			
Substandard loans	$ 3,387	$ 5,098	$
Real estate acquired via foreclosure	846	--	
Total classified assets	$ 4,233	$ 5,098	$
Classified assets to total loans plus other real estate owned (1)	0.79%	1.08%	

Classified assets to total assets	0.69%	0.95%
Classified assets to stockholders' equity	7.55%	10.16%
Allowance for loan losses to total classified assets	192.82%	130.74%

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(1) Total loans equals total gross loans less undisbursed loan funds and (less) or plus unamortized yield adjustments. Other real estate owned is included on a gross basis before any valuation allowances.

Substandard loans at December 31, 2002 included:

- $414 thousand in commercial loans to a business located in the Company's primary market area. These loans were paid off in full during the first quarter of 2003 in conjunction with the sale of the business.

- $326 thousand in commercial loans to a business where the sole stockholder and guarantor declared Chapter 11 bankruptcy in 2002. These loans have exhibited recurring payment delinquencies. The Company is currently working with the principal to fully reinstate the loans and obtain additional real estate collateral.

Special Mention loans at December 31, 2002 included:

- A $1.7 million residential first mortgage on a home located in Pebble Beach, California. The borrowers have exhibited chronic delinquency over the past several years, but have consistently reinstated the loan to avoid foreclosure. The home was appraised for $2.65 million in the fourth quarter of 2000.

- A $1.3 million commercial real estate loan secured by a motel in Palo Alto, California. The combination of the weak economic environment, the difficulties being experienced by the technology industry, and the general softness in business travel have all unfavorably impacted the operating results of the motel. The borrowers have, however, never been delinquent. The hotel was appraised for $1.96 million in mid-1999. Real estate valuations in the hospitality industry have been volatile, and generally declining, during the past two years due to factors such as consumer reaction to the events of September 11, 2001, reduced business travel, constrained recreational travel (including from overseas tourists) in response to international events, and the general weakness in the U.S. and California economies.

A savings institution's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS, which can require the establishment of additional general or specific loss allowances. The OTS, in conjunction with the other federal banking agencies, has adopted an interagency policy statement on allowances for loan and lease losses that provides guidance in determining the adequacy of general valuation guidelines. The policy statement recommends that savings institutions establish effective systems and controls to identify, monitor, and address asset quality problems, analyze significant factors that affect the collectibility of assets, and establish prudent allowance evaluation processes. Management believes that the Company's allowance for loan losses is adequate given the composition and risks of the loan portfolio. However, actual losses are dependent upon future events and, as such, further additions to the level of specific and general loan loss allowances may become necessary. In addition, there can be no assurance that at some time in the future the OTS, in reviewing the Company's loan

portfolio, will not request the Company to increase its allowance for loan losses, thus negatively impacting the Company's results of operations for that time period.

Impaired Loans. The Company defines a loan as impaired when it meets one or more of the following criteria:

- It is probable that the Company will be unable to collect all contractual principal and interest in accordance with the original terms of the loan agreement.
- The loan is ninety or more days past due.
- The loan is placed on non-accrual status although less than ninety days past due.
- A specific valuation reserve has been allocated against the loan.
- The loan meets the criteria for a troubled debt restructuring.

The policy of the Company is to review each loan in the portfolio to identify problem credits. The nature of this review varies by the type of loan and its underlying collateral. For example, most residential mortgages are evaluated for impairment following a delinquency, while the Company conducts credit analysis on each income property loan exceeding certain thresholds at least annually regardless of payment performance. In reviewing each loan, the Company evaluates both the amount the Company believes is probable that it will collect and the timing of such collection. As part of the loan review process, the Company considers such factors as the ability of the borrower to continue meeting the debt service requirements, assessments of other sources of repayment, and the fair value of any collateral. Insignificant delays or shortfalls in payment amounts, in the absence of other facts and circumstances, would not alone lead to the conclusion that a loan is impaired.

Each loan identified as impaired is evaluated for the need for a specific loss reserve. The adequacy of these specific loss reserves is reviewed regularly, and no less frequently than quarterly. A loan's specific loss reserve is calculated by comparing the Company's net investment in the loan to one or more of the following, as applicable to the nature of the loan:

- the present value of the loan's expected future cash flows discounted at the loan's effective interest rate at the date of initial impairment
- the loan's observable market price
- the fair value of the collateral securing the loan

The Company charges off a portion of an impaired loan against the specific valuation allowance when it is probable that a part of the loan will not be recoverable.

At December 31, 2002, the Company had impaired loans totaling $2.6 million, with a $462 thousand specific reserve for the loan secured in part by a hotel in the Company's primary market area, as discussed above in conjunction with non-accrual loans. At December 31, 2001, the Company had impaired loans of $2.3 million, which had no related specific reserves. Additional information concerning impaired loans is presented below and in Note 5 to the Consolidated Financial Statements.

	2002	2001	2000
	(Dollars In Thousands)		
Average investment in impaired loans for the year	$3,860	$2,304	$7,790
Interest recognized on impaired loans at December 31	$ 159	$ 146	$ 461
Interest not recognized on impaired loans at December 31	$ 18	$ 46	$ 110

The increase in the average investment in impaired loans in 2002 versus 2001 was primarily caused by the $2.3 million commercial real estate loan placed on non-accrual status in 2002, as discussed above, secured in part by a hotel in the Company's market area.

Other than those loans already categorized as non-performing or classified at December 31, 2002, the Company has not identified any other potential problem loans which would result in those loans being included as non-performing or classified loans at a future date.

The Company had no loans outstanding to foreign entities at December 31, 2002.

Allowance For Loan Losses. The allowance for loan losses is established through a provision for loan losses based on Management's evaluation of the risks inherent in the Company's loan portfolio, including unused commitments to provide financing. The allowance for loan losses is increased by provisions charged against earnings and reduced by net loan charge-offs. Loans are charged-off when they are deemed to be uncollectible; recoveries are generally recorded only when cash payments are received.

The allowance for loan losses is maintained at an amount management considers adequate to cover losses in loans receivable that are deemed probable and estimable. The allowance is based upon a number of factors, including, but not limited to, asset classifications, the size and mix of the loan portfolio, economic trends and conditions, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience, changes in non-performing and past due loans, and the Company's underwriting policies. While Management uses the best information available to make these estimates, future adjustments to allowances may be necessary due to economic, operating, regulatory, and other conditions that may be beyond the Company's control or ability to foresee.

The allowance for loan losses is comprised of three primary types of allowances:

1. Formula Allowance

Formula allowances are based upon loan loss factors that reflect Management's estimate of the inherent loss in various segments of or pools within the loan portfolio. The loss factor is multiplied by the portfolio segment (e.g. multifamily permanent mortgages)

balance (or credit commitment, as applicable) to derive the formula allowance amount. The loss factors are updated periodically by the Company to reflect current information that has an effect on the amount of loss inherent in each segment. The formula allowance at December 31, 2002 was $7.0 million, compared to $6.0 million at December 31, 2001.

2. Specific Allowance

Specific allowances are established in cases where management has identified significant conditions or circumstances related to an individually impaired credit. In other words, these allowances are specific to the loss inherent in a particular loan. The amount for a specific allowance is calculated in accordance with SFAS No. 114, "Accounting By Creditors For Impairment Of A Loan". The Company had $462 thousand in specific allowance at December 31, 2002 and no specific allowance at December 31, 2001.

3. Unallocated Allowance

The Company maintains an unallocated loan loss allowance that is based upon Management's evaluation of conditions that are not directly measured in the determination of the formula and specific allowances. The evaluation of inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or historical performance of loan portfolio segments. At December 31, 2002, the Company had $661 thousand in unallocated allowance, compared to $668 thousand at December 31, 2001. The conditions evaluated in connection with the unallocated allowance at December 31, 2002 included the following, which existed at the balance sheet date:

- General business and economic conditions affecting the Company's key lending areas
- Real estate values in California
- Loan volumes and concentrations
- Seasoning of the loan portfolio
- Status of the current business cycle
- Specific industry or market conditions within portfolio segments

In addition to the requirements of Accounting Principles Generally Accepted in the United States of America, or "GAAP", related to loss contingencies, a federally chartered savings association's determination as to the classification of its assets and the amount of its valuation allowances is subject to review by the OTS. The OTS, in conjunction with other federal banking agencies, provides guidance for financial institutions on both the responsibilities of management for the assessment and establishment of adequate allowances and guidance for banking agency examiners to use in determining the adequacy of general valuation allowances. It is required that all institutions:

- have effective systems and controls to identify, monitor, and address asset quality problems
- analyze all significant factors that affect the collectibility of the loan portfolio in a reasonable manner

o establish acceptable allowance evaluation processes that meet the objectives of the federal regulatory agencies

Various regulatory agencies, in particular the OTS, as an integral part of their examination process, periodically review the Company's allowance for loan losses. These agencies may require the Company to make additional provisions for loan losses, based on their judgments of the information available at the time of the examination. Although Management believes that the allowance for loan losses is adequate to provide for estimated inherent losses in the loan portfolio, future provisions charged against operations will be subject to continuing evaluations of the inherent risk in the loan portfolio. In addition, if the national or local economy declines or asset quality deteriorates, additional provisions could be required. Such additional provisions could negatively and materially impact the Company's financial condition and results of operations.

The following table presents information concerning the Company's allowance for loan losses at the dates and for the years indicated.

(Dollars In Thousands)	2002	2001	2000
Period end loans outstanding (1)	$ 531,636	$ 473,265	$ 397,1
Average loans outstanding (2)	483,429	432,020	379,8
Period end non-performing loans outstanding	2,643	2,252	4,7
Allowance for loan losses			
Balance, at beginning of year	$ 6,665	$ 5,364	$ 3,5
Charge-offs:			
Residential one to four unit real estate loans	--	--	(3
Other consumer loans	(11)	(4)	
Commercial term loans	(11)	--	
Commercial lines of credit	(19)	(95)	
Total charge-offs	(41)	(99)	(3
Recoveries:			
Residential one to four unit real estate loans	--	--	
Other consumer loans	5	--	
Commercial lines of credit	23	--	
Total recoveries	28	--	
Net (charge-offs) recoveries	(13)	(99)	(3
Provision charged to operations	1,510	1,400	2,1
Allowance acquired in conjunction with loan purchase	--	--	

Balance, at end of year	$ 8,162	$ 6,665	$ 5,3
Net charge-offs (recoveries) to average loans outstanding (2)	0.00%	0.02%	0.
Allowance as a percent of year end loans outstanding (1)	1.54%	1.41%	1.
Allowance as a percent of non-performing loans	308.82%	295.96%	113.

(1) net of undisbursed loan funds, unamortized purchase premiums net of unamortized purchase discounts, and deferred loan fees and costs, net

(2) net of undisbursed loan funds, unamortized purchase premiums net of unamortized purchase discounts, deferred loan fees and costs, net, and allowances for loan losses

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The following table provides a summary of the allocation of the allowance for loan losses for specific loan categories at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for loan losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each loan category represents the total amounts available for future losses that may occur within these categories. The unallocated portion of the allowance and the total allowance is applicable to the entire loan portfolio.

	At December 31,					
	2002		2001		2000	
(Dollars In Thousands)	Amount	% Of Loans In Category To Gross Loans(1)	Amount	% Of Loans In Category To Gross Loans(1)	Amount	% Loans Catego To Gro Loans(
Residential	$ 840	33.1%	$ 1,710	42.2%	$ 1,143	37.8
Multifamily	956	20.8%	713	21.4%	470	18.1
Commercial real estate	3,145	24.7%	2,374	22.7%	1,232	24.1
Construction	1,209	12.3%	525	7.9%	1,164	13.9
Land	776	4.4%	336	2.5%	400	3.9
Home equity lines of credit	55	1.5%	30	1.4%	32	1.3
Other consumer loans	10	0.1%	11	0.1%	11	0.2
Commercial term loans	158	0.9%	111	0.6%	148	0.4
Commercial lines of credit	352	2.2%	187	1.2%	25	0.3
Total allocated	7,501	100.0%	5,997	100.0%	4,625	100.0
Unallocated	661		668		739	
Total	$ 8,162		$ 6,665		$ 5,364	

Other information

Gross loans outstanding held for investment	$567,053	$484,940	$423,945

	At December 31,			
	1999		1998	
(Dollars In Thousands)	Amount	% Of Loans In Category To Gross Loans(1)	Amount	% Of Loans In Category To Gross Loans(1)
Residential	$ 663	43.4%	$ 925	56.1%
Multifamily	185	10.9%	277	10.2%
Commercial real estate	918	18.6%	514	12.2%
Construction	960	20.3%	533	15.7%
Land	137	3.6%	101	2.4%
Home equity lines of credit	32	1.0%	34	1.0%
Other consumer loans	15	0.2%	11	0.2%
Commercial term loans	243	1.7%	190	2.0%
Commercial lines of credit	83	0.3%	26	0.2%
Total allocated	3,236	100.0%	2,611	100.0%
Unallocated	266		169	
Total	$ 3,502		$ 2,780	
Other information				
Gross loans outstanding held for investment	$388,198		$327,876	

(1) Gross loans held for investment

Over the past several years, the Company has increased its allowance for loan losses in conjunction with three key trends within the loan portfolio:

- The growth in the nominal size of the loan portfolio has led Management to increase the amount of the allowance.

- The greater diversification in the mix of the loan portfolio away from residential one to four unit permanent mortgages toward other types of lending, particularly income property loans, has led to higher nominal and relative allowance levels, as these types of lending typically present more risk than residential mortgages. This increased risk stems both from the nature of the lending and the greater individual credit amounts associated with income property loans.

- The increasing concentration of the portfolio in relatively less seasoned credits, because of the Company's growth rate in recent years, has also led

Management to increase the level of the allowance, as less seasoned loans typically present greater risk than loans which have been performing for many years and which have amortized balances.

The Company's loan portfolio at December 31, 2002 presented significant geographic concentration, consistent with the Company's focus of serving local individuals and businesses as a community commercial bank. The majority of the Company's loans outstanding at December 31, 2002 were secured by real estate or associated with businesses located in the three counties that constitute the Company's primary market area:

- Santa Cruz County
- Monterey County
- Santa Clara County

However, with the opening of the Los Angeles loan production office in 2002 and the Company's acquiring loan participations and purchasing loans secured by real estate located in a greater number of California communities, the Company is gradually reducing its geographic lending concentration.

The Company's geographic lending concentration provides certain benefits. For example, the Company becomes well known in its local area and therefore attracts more business. In addition, Management develops a more comprehensive knowledge of real estate values and business trends in markets where lending is regularly conducted. However, this concentration also presents certain risks. A natural disaster such as an earthquake centered in the Greater Monterey Bay Area would impact the Company more significantly than firms with loans geographically dispersed over a wider area. Another concentration risk is that a downturn in the economy or real estate values in the Greater Monterey Bay Area would disproportionately unfavorably impact the Company versus a multi-state or national lender. The geographic concentration of the Company's loans and the Company's almost complete focus on doing business in California is an important factor that Management considers in determining appropriate levels of loan loss reserves.

At December 31, 2002, the Company had outstanding less than $4.0 million in loans outside the State of California. The Company's strategic plan does not include substantial lending in 2003 outside the State of California.

During 2002, among the changes implemented to the Company's loan loss reserve methodology were revisions in the formula allowances for the following types of loans::

Increases In Formula Allowances	Decreases In Formula Allowances
1. Commercial real estate loans	1. Residential one to four unit mortgages
2. Income property construction loans	
3. Commercial business lines of credit	

Formula allowances were increased for commercial real estate loans and income property construction loans due to:

- less favorable operating results for various types of commercial real estate, particularly properties associated with the hospitality industry,

highlighted as the Company received financial statements during 2002 for 2001 full year and 2002 partial year performance

- o the concentration of credit risk stemming from larger average loan sizes

- o the portfolio's relative lack of seasoning

- o unfavorable market trends in rents for many types of income property

Formula allowances were increased for commercial business lines of credit due to:

- o the weak state of the economy, which impacted revenues received by a number of the Company's business clients

- o increased, although generally cured, delinquencies, as certain businesses experienced delayed collections of accounts receivable and / or a rise in uncollectible receivables

- o the portfolio's relative lack of seasoning

Formula allowances were decreased for residential mortgages due to:

- o the increasing seasoning of that portfolio, as a significant portion of the new production in 2002 was sold servicing released into the secondary market

- o the strength of residential real estate valuations in many of the Company's markets, with the exception of high end properties

- o the Company's favorable delinquency and credit loss experience on this portfolio in recent periods

The $661 thousand in unallocated allowance at December 31, 2002 reflected the Company's consideration of the following factors, as well as more general factors including the condition of the State and national economies, increased layoffs and unemployment, the high level of continuing jobless claims, the weak equity markets, and a significant California State budget deficit:

- o The adverse effects of a decline in tourism impacting the local economies in Santa Cruz and Monterey counties, with a concomitant impact upon net cash flows for local commercial enterprises, commercial real estate properties, and owner / operators of small businesses, which could be in the range of $100 thousand to $300 thousand.

- o The adverse impacts of the weak technology and telecommunications industries upon commercial real estate values. The Company's primary lending area is near the Silicon Valley area of the San Francisco Bay Area, which has been impacted by the slump in various technology and technology related businesses. This impact could be in the range of $100 thousand to $1.0 million.

Management anticipates that should the Company accomplish its strategic plan and be successful in:

- o generating further growth in loans receivable held for investment,

o emphasizing the origination and purchase of income property real estate loans,

o continuing expansion of commercial business lending, and

o reducing the portfolio concentration in relatively lower risk residential mortgages,

future provisions will result and the ratio of the allowance for loan losses to loans outstanding will increase in a manner consistent with the Company's loan loss allowance methodology. Experience across the financial services industry indicates that commercial business and income property loans present greater risks than residential real estate loans, and therefore should be accompanied by suitably higher levels of reserves.

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Investment Activities

Cash Equivalents. The Company does not include certain short term, highly liquid investments as investment securities, instead classifying these as cash equivalents. These include:

o federal funds sold
o securities purchased under agreements to resell
o commercial paper
o money market mutual fund investments
o banker's acceptances
o certificates of deposit in federally insured financial institutions

Liquidity Maintenance. Federally chartered savings institutions have the authority to invest in various types of liquid assets, as defined in applicable regulations, including United States Treasury obligations, securities of or guaranteed by various federal agencies, certificates of deposit of insured banks and savings institutions, bankers' acceptances, repurchase agreements, and federal funds. Additionally, under OTS regulations, the Bank must maintain a safe and sound level of liquidity at all times. Management agrees that maintaining an adequate level of liquidity at all times is fundamental to effective guidance of a financial institution. Management believes that the Bank at all times in 2002 maintained a level of available liquidity considered to be adequate to meet foreseeable operational needs.

Investment Policies. In addition to the above liquid assets, subject to various restrictions, federally chartered savings institutions may also invest in various other types of securities, including investment-grade corporate debt securities, asset-backed securities, collateralized mortgage obligations not guaranteed by a federal agency, and mutual funds whose assets conform to the investments that a federally chartered savings institution is otherwise authorized to make directly. The Company maintains separate internal investment policies for the Bank and MBBC. These policies are established by the Board of Directors with the key objectives of:

o providing and maintaining liquidity

o generating a favorable total return on a risk-adjusted basis

o managing the overall interest rate risk profile of the entities

o maintaining compliance with various associated regulations

o controlling credit risk exposure

Specifically, the Company's policies generally limit investments to publicly traded securities that are investment grade. These policies prohibit the Company's maintenance of a trading portfolio as defined under SFAS No. 115.

Accounting And Reporting. Investment securities classified as available for sale are recorded at fair value, while investment securities classified as held to maturity are recorded at cost. Unrealized gains or losses on available for sale securities, net of the deferred tax effect, are reported as a component of other comprehensive income and are included in stockholders' equity. At December 31, 2002, 2001, and 2000, all of the Company's investments were classified as available for sale.

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The amortized cost and estimated fair value of securities are presented in the following tables. "PT" represents "pass-through" and "CMO" represents "collateralized mortgage obligation".

(Dollars In Thousands) Available for sale	December 31, 2002 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Variable rate corporate trust preferred securities	$ 7,719	$ --	$ (689)
Fixed rate FHLMC PT's	957	49	--
Fixed rate FNMA PT's	452	35	--
Fixed rate GNMA PT's	497	34	--
Variable rate FNMA PT's	3,101	50	--
Fixed rate FHLMC balloons	8,679	48	--
Fixed rate CMO's:			
Agency issuance	23,512	74	(22)
Total	$44,917	$ 290	$ (711)

(Dollars In Thousands) Available for sale	December 31, 2001 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Variable rate corporate trust preferred securities	$ 7,707	$ --	$ (407)
Fixed rate FHLMC PT's	1,551	34	--
Fixed rate FNMA PT's	585	38	--
Fixed rate GNMA PT's	744	31	--
Variable rate FNMA PT's	4,629	62	--
Fixed rate FHLMC balloons	1,956	--	--
Fixed rate CMO's:			

Agency issuance	17,062	86	--
Non Agency issuance	3,831	35	--
Total	$38,065	$ 286	$ (407)

(Dollars In Thousands)	December 31, 2000		
Available for sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
Variable rate corporate trust preferred securities	$ 7,696	$ --	$ (336)
Fixed rate FHLMC PT's	1,090	13	--
Fixed rate FNMA PT's	3,649	25	(2)
Fixed rate GNMA PT's	1,060	--	(11)
Variable rate FNMA PT's	571	5	--
Fixed rate CMOs:			
Agency issuance	19,095	5	(266)
Non Agency issuance	18,210	4	(498)
	$51,371	$ 52	$(1,113)

At December 31, 2002, the Company's investment in corporate trust preferred securities was entirely composed of variable rate securities which reprice every three months based upon a margin over the three month LIBOR rate. These corporate trust preferred securities were all rated "A-" or better by Standard & Poors ratings agency at December 31, 2002.

All of the Company's mortgage backed securities at December 31, 2002 were rated AAA by at least one nationally recognized rating agency.

Over the past several years, the Company has restructured its security portfolio in pursuing the following objectives:

- generating a steady stream of cash flows to provide liquidity in support of the expanding loan portfolio
- increasing the interest rate sensitivity of the portfolio in conjunction with the Company's asset / liability management program
- maintaining sufficient US Agency PT's and CMO's to provide collateral for various types of secured deposits, primarily funds placed with the Bank by the State of California under its time deposit program
- increasing the investment in CMO's and balloon mortgage backed securities versus PT's in order to better tailor the portfolio's cash flows to the projected liquidity needs of the Company
- classifying all securities as available for sale in order to provide additional flexibility in balance sheet management

The following table presents certain information regarding the amortized cost, estimated fair value, weighted average yields, and contractual maturities of the Company's securities as of December 31, 2002. Actual maturities may differ from contractual maturities due to principal prepayments, priority of principal allocation within collateralized mortgage obligations, or rights of issuers to call obligations prior to maturity.

(Dollars In Thousands)	At December 31, 2002			
Available for sale securities	2003	2004 Through 2007	2008 Through 2012	Therea
Variable rate corporate trust preferred securities	$ --	$ --	$ --	$ 7
Fixed rate FHLMC PT's	--	--	--	
Fixed rate FNMA PT's	--	--	--	
Fixed rate GNMA PT's	--	--	409	
Variable rate FNMA PT's	--	--	--	3
Fixed rate FHLMC balloons	--	--	8,679	
Agency fixed rate CMO's	--	--	--	23
Total amortized cost	$ --	$ --	$ 9,088	$ 35
Estimated fair value	$ --	$ --	$ 9,164	$35
Weighted average yield (1)	--	--	3.28%	1

(1) Weighted average yield is calculated based upon estimated fair value.

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The weighted average yield for securities with stated maturities in 2013 and thereafter at December 31, 2002 was limited by:

- the fact that many of the CMO's were short term in nature, despite a longer stated maturity date, and thus provided yields closer to the target federal funds rate of 1.25%

- high prepayment speeds in December 2002 for mortgage related securities decreased the effective yield for those securities owned at a premium to par value

In the third and fourth quarters of 2002, the Company reduced the target duration of its security portfolio in conjunction with its asset / liability management program.

The Company maintained no tax-preferenced securities at December 31, 2002. At December 31, 2002, the Company did not own debt securities issued by any one issuer other than US Agencies that exceeded ten percent of stockholders' equity. For additional information regarding the Company's securities, please refer to Notes 3 and 4 to the Consolidated Financial Statements.

Sources Of Funds

General. The Company's primary sources of funds are customer deposits, principal, interest, and dividend payments on loans and securities, FHLB advances and other borrowings, and, to a lesser extent, brokered deposits and proceeds from sales of securities and loans. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and loan and security prepayments are greatly influenced by general interest rates, economic conditions, and competition.

Deposits. The Company offers a variety of deposit accounts with a range of interest rates, features, and terms. The Company's deposits consist of demand deposit and NOW checking accounts, savings accounts, money market accounts, and certificates of deposit. The flow of deposits is influenced significantly by general economic conditions, events in the capital markets, money supply, prevailing interest rates, and competition. The Company's deposits are obtained predominantly from the areas in which its full service branch offices are located. The Company relies primarily on customer service and long standing relationships with customers to attract and retain these deposits; however, market interest rates and rates offered by competing financial institutions and mutual funds significantly affect the Company's ability to attract and retain deposits. At December 31, 2002, the Bank had $20.0 million in brokered certificates of deposit. The Bank participates in the State of California Time Deposit Program, whereby the State places certificates of deposit with banks as a means of encouraging lending back into California's communities. Management regularly monitors the Company's certificate accounts and historically the Company has retained a large portion of such accounts upon maturity.

The Company's strategic plan incorporates increasing the percentage of deposits represented by transaction accounts. Management believes that transaction accounts present the opportunity to strengthen customer relationships, build franchise value, generate fee income, and lower the Company's relative cost of funds. In addition, an expansion in transaction accounts supports the Company's asset / liability management program, as transaction accounts are generally less interest rate sensitive than most alternative sources of funding.

In recent years, the Company has offered a series of money market deposit accounts specifically designed for certain target markets. Customers wishing to avoid account maintenance fees and maintain low minimum balances are marketed the Company's Easy Access money market account. Customers planning to maintain particularly high average balances are marketed the Company's highly tiered and more aggressively priced Investors Money Market account. Customers in between these two profiles are marketed the competitively priced Lighthouse and Money Market Plus money market accounts. In addition, the Company introduced its Business Money Market account product at the beginning of 2003. This product is tiered and priced to be an attractive alternative for excess liquid funds maintained by the Company's commercial customers. All five of these money market products offer check writing, 24 hour bilingual telephone banking, Internet banking, ATM access, bank by mail, and in-branch service. As a result of this target marketing, money market deposit balances have increased in recent years, from $87.7 million at December 31, 2000 to $105.8 million at December 31, 2001 to $126.1 million at December 31, 2002. Expansion in money market balances during 2001 and 2002 benefited from the interest rate environment, as certain customers were less interested in committing to term certificates of deposit with interest rates at historically low levels.

The Company's other area of focus in deposit acquisition in recent years has been checking accounts, coincident with the Company's business strategy of becoming more of a community based financial services organization, meeting the primary financial needs of both consumers and small businesses. Total checking balances expanded from $63.6 million at December 31, 2001 to $67.2 million at December 31, 2002.

The rise in checking account balances during 2002 was supported by increased checking account balances maintained by local businesses with which the Company established comprehensive relationships in 2002 and 2001, including such services as lines of credit, courier service, real estate financing, letters of credit, and dedicated account relationship officers. The Company further augmented its business checking product line in 2002 with the introduction of Internet banking for businesses and remote deposit service. Via the Company's remote deposit service, business and high balance individual customers can make deposits to their Monterey Bay Bank checking accounts at any of approximately 4,900 branches of a correspondent bank located in 23 states.

The Company also plans to augment its line of consumer checking products in 2003, with improved customer statements and continued marketing of Internet banking for consumers, including electronic bill payment.

At December 31, 2002, all of the Company's deposit products were statement based (i.e. no passbooks). Management believes that statement based products integrate more effectively with the increasingly numerous and varied means of customer electronic access to their funds; e.g. Internet banking, electronic bill payment, debit card / point of sale, ATM networks, and telephone banking.

During 2002, the Company's certificate of deposit portfolio increased by $2.9 million, as the issuance of a $20.0 million brokered certificate of deposit and a $9.0 million increase in funds from the State of California Time Deposit Program more than offset customer transfers of funds from certificates of deposit into money market accounts due to the historically low interest rate environment. During the past several years, the Company has focused its deposit related sales efforts on transaction accounts as a means of increasing net interest margins, bolstering fee income, and building more comprehensive customer relationships.

The Company's weighted average cost of deposits at December 31, 2002 was 1.94%, equal to 44 basis points below the 11th District Cost Of Funds Index ("COFI") for December 2002 of 2.38%. While COFI contains funding components other than deposits, the Company uses a comparison to COFI as a benchmark of its success in managing its cost of deposits. The Company seeks to manage its cost of deposits both via pricing for individual products and through the deposit portfolio product mix.

The Company maintained no deposits in foreign banking offices at December 31, 2002 or December 31, 2001.

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The Company's weighted average cost of deposits decreased significantly in 2002 primarily due to:

o the shift in product mix towards transaction accounts and away from relatively higher costing certificates of deposit

o the general decrease in interest rate levels, assisted by the Federal

Reserve's cutting its target federal funds rate by 50 basis points in November 2002

- o certificates of deposit repricing downward upon maturity and rollover, often significantly, in response to the decrease in interest rates during 2002 and 2001

The following table summarizes the Company's deposits at the dates indicated.

(Dollars In Thousands)	December 31, 2002		Decem
	Balance	Weighted Average Rate	Balance
Demand deposit accounts	$ 23,549	--	$ 21,062
NOW accounts	43,629	0.16%	42,557
Savings accounts	18,474	0.33%	19,127
Money market accounts	126,061	1.79%	105,828
Certificates of deposit <$100,000	133,795	2.66%	156,351
Certificates of deposit $100,000 or more	112,826	2.59%	87,414
	$458,334		$432,339
Weighted average nominal interest rate		1.94%	

The weighted average interest rates are at the end of the period and are based upon stated interest rates without giving consideration to daily compounding of interest or forfeiture of interest because of premature withdrawal.

The following table presents the amount and weighted average rate of time deposits equal to or greater than $100,000 at December 31, 2002. The amount maturing in three months or less includes $22.1 million associated with the State of California Time Deposit Program. At December 31, 2002, under the State of California Time Deposit Program, certificate of deposit maturities were limited to terms of six months or less.

(Dollars In Thousands)	At December 31, 2002	
Maturity Period	Amount	Weighted Average Rate
Three months or less	$ 41,277	2.32%
Over 3 through 6 months	33,834	2.40%
Over 6 through 12 months	15,632	2.61%
Over 12 months through 2 years	13,831	2.81%
Over 2 through 3 years	3,389	3.78%
Over 3 years	4,863	4.70%
Total	$ 112,826	2.59%

The following table presents the amount and weighted average rate of time deposits less than $100,000 at December 31, 2002.

(Dollars In Thousands) Maturity Period	At December 31, 2002 Amount	Weighted Average Rate
Three months or less	$ 32,421	2.66%
Over 3 through 6 months	28,370	2.17%
Over 6 through 12 months	30,790	2.28%
Over 12 months through 2 years	27,761	2.68%
Over 2 through 3 years	7,533	4.13%
Over 3 years	6,920	4.68%
Total	$ 133,795	2.66%

The following table presents the distribution of the Company's average balances of deposit accounts for the periods indicated and the weighted average interest rates on each category of deposits presented.

	For The Year Ended December 31,						
	2002			2001			
	Average Balance	% Of Average Total Deposits	Weighted Average Rate	Average Balance	% Of Average Total Deposits	Weighted Average Rate	Averag Balanc
	(Dollars In Thousands)						
Demand deposits	$ 22,856	5.1%	--	$ 19,104	4.6%	--	$ 16,72
NOW accounts	43,607	9.7%	0.34%	40,944	9.8%	0.89%	36,31
Savings accounts	18,732	4.2%	0.52%	19,370	4.6%	1.12%	15,80
Money market accounts	114,629	25.5%	2.11%	92,237	22.1%	3.74%	87,73
Certificates of deposit	249,088	55.5%	3.13%	246,315	58.9%	5.04%	230,09
Total	$448,912	100.0%	2.33%	$417,970	100.0%	3.93%	$386,67

Please refer to Note 10 to the Consolidated Financial Statements for additional information concerning deposits.

Borrowings

From time to time, the Company obtains borrowed funds through FHLB advances, federal funds purchased, MBBC's line of credit, and securities sold under agreements to repurchase. Borrowings are used to supplement deposits as a source of funding. Borrowings are also used as a tool in the Company interest rate risk management process.

FHLB advances are collateralized by the Bank's pledged mortgage loans, pledged mortgage backed securities, and investment in the capital stock of the FHLB. See "Regulation And Supervision - Federal Home Loan Bank System." FHLB advances are made pursuant to several different credit programs with varying interest rate, embedded option (callable / putable), amortization, and maturity terms. All of the Bank's FHLB advances outstanding at December 31, 2002 were either overnight borrowings or fixed rate, non-amortizing advances with single individual maturity dates ("bullet advances"). The maximum amount that the FHLB will advance to member institutions, including the Bank, fluctuates from time to time in accordance with the policies of the FHLB. During 2002, the Bank periodically used FHLB advances to provide needed liquidity and to manage the term structure and maturities of its liabilities.

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From time to time, the Company enters into reverse repurchase agreements (securities sold under agreements to repurchase) with approved security dealers.

The Bank maintains federal funds lines of credit with five correspondent banks. These lines are not committed lines, but rather function on a funds availability basis. From time to time, the Bank borrows federal funds from its correspondent banks as a source of short term liquidity.

MBBC maintains a committed $3.0 million revolving line of credit with one of the Bank's correspondent banks. This line of credit expires in March 2003, and is collateralized by 800,000 shares of the Company's treasury stock. Funds drawn on the line are priced based upon either the London Inter-Bank Offer Rate curve ("LIBOR") or the correspondent bank's reference rate. This line of credit contains various financial performance covenants on the part of the Company. The line of credit agreement does not restrict the Company's ability to declare and pay cash or stock dividends. The line of credit agreement also contains no restrictions on the use of funds to repurchase Company common stock.

The following table sets forth information regarding the Company's FHLB advances at or for the indicated years.

(Dollars In Thousands)	At Or For The Year Ended	
	2002	200
FHLB Advances		
Average balance outstanding	$ 57,355	$ 47,52
Weighted average rate on average balance outstanding	4.25%	5.30
Year end balance outstanding	$ 93,582	$ 53,58
Weighted average rate on year end balance outstanding	3.02%	4.46
Maximum amount outstanding at any month end during the year	$ 93,582	$ 65,58

Please refer to Notes 11 and 12 to the Consolidated Financial Statements for additional information regarding borrowings and lines of credit.

Subsidiary Activities

Portola, a California corporation wholly owned by the Bank, is engaged, on an agency basis, in the sale of insurance, mutual funds, individual securities, and annuity products, primarily to the Bank's customers and members of the local communities which the Bank serves. During 2002, gross commission income generated through Portola included $39 thousand for mutual fund sales, $21 thousand from sales of individual securities, $15 thousand for variable annuity sales, $10 thousand for life insurance sales, and $8 thousand for fixed annuity sales. Portola also functions as trustee for the Bank's deeds of trust. At December 31, 2002, Portola had $37 thousand in total assets. Portola's revenues in 2002 were constrained by the capital markets environment and by vacancies in investment sales representative positions.

Personnel

As of December 31, 2002, the Company had 112 full-time employees and 14 part-time employees. The employees are not represented by a collective bargaining unit. The Company considers its relationship with its employees to be good.

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REGULATION AND SUPERVISION

General

Savings and loan holding companies and savings associations are extensively regulated under both federal and state law. This regulation is intended primarily for the protection of depositors and the FDIC Insurance Funds and not for the benefit of stockholders of the Company. The following information describes certain aspects of that regulation applicable to the Company and the Bank, and does not purport to be complete. The following discussion is qualified in its entirety by reference to all particular statutory or regulatory provisions.

Regulation of the Company

General. MBBC is a unitary savings and loan holding company subject to regulatory oversight by the OTS. As such, MBBC is required to register and file reports with the OTS and is subject to regulation and examination by the OTS. In addition, the OTS has enforcement authority over MBBC and its subsidiaries, which also permits the OTS to restrict or prohibit activities that are determined to be a serious risk to the subsidiary savings association. MBBC is also governed by federal regulations that restrict transactions between the Bank and MBBC.

Although savings and loan holding companies are not, at December 31, 2002, subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions, the Home Owners Loan Act ("HOLA") does prescribe such restrictions on subsidiary savings institutions, as described below. The Bank must notify the OTS 30 days before declaring any dividend to MBBC.

The HOLA prohibits a savings and loan holding company directly, or indirectly, or through one or more subsidiaries, from acquiring more than 5% of

the voting stock of another savings institution or holding company thereof, without prior written approval of the OTS; acquiring or retaining, with certain exceptions, more than 5% of a non-subsidiary company engaged in activities other than those permitted by the HOLA; or acquiring or retaining control of a depository institution that is not insured by the FDIC. In evaluating applications by holding companies to acquire savings institutions, the OTS must consider the financial and managerial resources and future prospects of the company and institution involved, the effect of the acquisition on the risk to the deposit insurance funds, the convenience and needs of the community, and competitive factors.

Activities Restriction Test. As a unitary savings and loan holding company, MBBC is generally not subject to activity restrictions, provided the Bank satisfies the Qualified Thrift Lender ("QTL") test or meets the definition of domestic building and loan association pursuant to the Internal Revenue Code of 1986, as amended (the "Code"). MBBC presently intends to continue to operate as a unitary savings and loan holding company. Federal legislation terminated the "unitary thrift holding company exemption" for all companies that apply to acquire savings associations after May 4, 1999. Since the Company is grandfathered, its unitary holding company powers and authorities were not affected. See "Financial Services Modernization Legislation." However, if MBBC acquires control of another savings association as a separate subsidiary, it would become a multiple savings and loan holding company, and the activities of MBBC and any of its subsidiaries (other than the Bank or any other SAIF-insured savings association) would become subject to restrictions applicable to bank holding companies unless such other associations each also qualify as a QTL or domestic building and loan association and were acquired in a supervisory acquisition. Furthermore, if MBBC were in the future to sell control of the Bank to any other company, such company would not succeed to MBBC's grandfathered status under and would be subject to the same business activity restrictions. See "Regulation of the Bank - Qualified Thrift Lender Test."

Restrictions on Acquisitions. MBBC must obtain approval from the OTS before acquiring control of any other SAIF-insured association. Such acquisitions are generally prohibited if they result in a multiple savings and loan holding company controlling savings institutions in more than one state. However, such interstate acquisitions are permitted based on specific state authorization or in a supervisory acquisition of a failing savings association.

Federal law generally provides that no "person," acting directly or indirectly or through or in concert with one or more other persons, may acquire "control," as that term is defined in OTS regulations, of a federally insured savings association without giving at least 60 days written notice to the OTS and providing the OTS an opportunity to disapprove the proposed acquisition. In addition, no company may acquire control of such an institution without prior OTS approval. These provisions also prohibit, among other things, any director or officer of a savings and loan holding company, or any individual who owns or controls more than 25% of the voting shares of a savings and loan holding company, from acquiring control of any savings association not a subsidiary of the savings and loan holding company, unless the acquisition is approved by the OTS. For additional restrictions on the acquisition of a unitary thrift holding company, see "- Financial Services Modernization Legislation."

The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law The Sarbanes-Oxley Act

of 2002. This new legislation addresses accounting oversight and corporate governance matters, including:

- o the creation of a five-member oversight board appointed by the SEC that will set standards for accountants and have investigative and disciplinary powers
- o the prohibition of accounting firms furnishing audit services from providing various types of consulting and non-audit services to public clients
- o requiring accounting firms to rotate partners among public client assignments every five years
- o enhanced independence of board audit committees
- o the prohibition of most personal loans to directors and executive officers (loans by the Bank in accordance with Regulation O are exempt)
- o protection of whistle-blowers
- o increased civil and criminal penalties for financial crimes
- o expanded disclosure of corporate operations and internal controls and required certification of SEC filings containing financial information
- o enhanced controls on, and reporting of, insider trading
- o statutory separations between investment bankers and analysts

Following the passage of the Sarbanes-Oxley Act of 2002, the SEC undertook a number of initiatives to implement and help ensure compliance with the Act. New SEC rules adopted as a result of the Sarbanes-Oxley Act of 2002 have addressed:

- o conditions for the disclosure of non-GAAP financial information
- o current report requirements on Form 8-K were expanded to require public companies to include earnings releases or similar announcements in a Form 8-K filing with the SEC
- o public companies must disclose whether any members of their audit committee are considered to be audit committee financial experts, and, if not, why not
- o public companies must disclose certain information about codes of conduct
- o trading restrictions for company insiders in conjunction with pension fund blackout periods
- o an expansion in the scope of the retention of records relevant to audits and reviews
- o increased disclosure requirements for off-balance sheet transactions and arrangements and contractual obligations
- o strengthened rules for auditor independence

- expanded communications between the independent auditor and the Board Audit Committee

The primary impacts upon the Company from the Sarbanes-Oxley Act of 2002 will be increased reporting requirements and higher professional fees for legal and accounting services. As a highly regulated savings and loan holding company and financial institution, MBBC and the Bank were already subject to many of the types of operating restrictions and financial control requirements implemented following the passage of the Sarbanes-Oxley Act of 2002.

California Corporate Disclosure Act

On September 18, 2002, the Governor of California signed the California Corporate Disclosure Act ("Disclosure Act"). The Disclosure Act is effective January 1, 2003 and changes the current biennial filings of corporations doing business in the State to an annual filing and, more importantly, (a) requires significant additional information that publicly traded California domestic and foreign corporations qualified in California must include in the Statement and (b) requires that each filing corporation certify that the information in the Statement is true and correct.

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In addition to the information required of all corporations, every publicly traded company subject to the act (such as the Company) must also include the following information in the Statement:

- two years of information on the corporation's independent auditor and the services provided by such auditor

- the date of the last audit report prepared by the independent auditor and a copy of such report

- information on annual compensation of the board and the executive officers

- two years of information on director loans

- information about any bankruptcy filings by the corporation, its executive officers or directors in the last 10 years

- information about any fraud convictions by the executive officers or board members in the last ten years

- information about corporate violations of any federal security laws or any banking or security provision of California law in the last 10 years for which the corporation was found liable in an action before a federal or state court or regulatory agency or a self-regulatory organization with judgments over $10 thousand

The Company does not expect the added disclosure associated with the Disclosure Act to have a material adverse effect on its operations or financial condition.

USA Patriot Act of 2001

On October 26, 2001, President Bush signed the USA Patriot Act of 2001. The Patriot Act is intended is to strengthen U.S law enforcement's and the

intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The potential impact of the Act on financial institutions of all kinds is significant and wide ranging. The Act contains sweeping anti-money laundering and financial transparency laws in addition to previous requirements, and requires various regulations, including:

- due diligence requirements for financial institutions that administer, maintain, or manage private banks accounts or correspondent accounts for non-US persons
- standards for verifying customer identification at account opening
- rules to promote cooperation among financial institutions, regulators, and law enforcement entities in identifying parties that may be involved in terrorism or money laundering
- reports by non-financial businesses filed with the Treasury Department's Financial Crimes Enforcement Network for transactions exceeding $10,000, and
- filing of suspicious activities reports securities by brokers and dealers if they believe a customer may be violating U.S. laws and regulations.

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On July 23, 2002, the U.S. Treasury proposed regulations requiring institutions to incorporate into their written money laundering plans, a board approved customer identification program implementing reasonable procedures for:

- verifying the identity of any person seeking to open an account, to the extent reasonable and practicable
- maintaining records of the information used to verify the person's identity
- determining whether the person appears on any list of known or suspected terrorists or terrorist organizations

Account is defined as a formal banking or business relationship established to provide ongoing services, dealings, or other financial transactions.

Financial Services Modernization Legislation

General. On November 12, 1999, President Clinton signed into law the Gramm-Leach-Bliley Act of 1999 (the "GLB"). The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company system to engage in a full range of financial activities through a new entity known as a "financial holding company." "Financial activities" is broadly defined to include not only banking, insurance, and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The GLB provides that no company may acquire control of an insured

savings association unless that company engages, and continues to engage, only in the financial activities permissible for a financial holding company, unless grandfathered as a unitary savings and loan holding company. The GLB grandfathers any company that was a unitary savings and loan holding company on May 4, 1999 or became a unitary savings and loan holding company pursuant to an application pending on that date. Such a company may continue to operate under present law as long as the company continues to meet the two tests: it can control only one savings institution, excluding supervisory acquisitions, and each such institution must meet the QTL test. Such a grandfathered unitary savings and loan holding company also must continue to control at least one savings association, or a successor institution, that it controlled on May 4, 1999.

The GLB also permits national banks to engage in expanded activities through the formation of financial subsidiaries. A national bank may have a subsidiary engaged in any activity authorized for national banks directly or any financial activity, except for insurance underwriting, insurance investments, real estate investment or development, or merchant banking, which may only be conducted through a subsidiary of a financial holding company. Financial activities include all activities permitted under new sections of the Bank Holding Company Act or permitted by regulation.

The Company and the Bank do not believe that the GLB has had or will have a material adverse effect on their operations in the near-term. However, to the extent that the act permits banks, securities firms, and insurance companies to affiliate, the financial services industry may experience further consolidation. The GLB is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies already possess. Nevertheless, this Act may have the result of increasing the amount of competition that the Company and the Bank face from larger institutions and other types of companies offering financial products, many of which may have substantially more financial resources than the Company and the Bank.

Privacy. Under the GLB, federal banking regulators adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Pursuant to these rules, effective July 1, 2001, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and
- a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

These privacy provisions affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

Consumer Protection Rules - Sale of Insurance Products. In December 2000, pursuant to the requirements of the GLB, the federal bank and thrift regulatory agencies adopted consumer protection rules for the sale of insurance products by depository institutions. The rules were effective on April 1, 2001. The final rule applies to any depository institution or any person selling, soliciting, advertising, or offering insurance products or annuities to a

consumer at an office of the institution or on behalf of the institution. Before an institution can complete the sale of an insurance product or annuity, the regulation requires oral and written disclosure that such product:

- is not a deposit or other obligation of, or guaranteed by, the depository institution or its affiliate;
- is not insured by the FDIC or any other agency of the United States, the depository institution or its affiliate; and
- has certain risks in investment, including the possible loss of value.

Finally, the depository institution may not condition an extension of credit:

- on the consumer's purchase of an insurance product or annuity from the depository institution or from any of its affiliates, or
- on the consumer's agreement not to obtain, or a prohibition on the consumer from obtaining, an insurance product or annuity from an unaffiliated entity.

The rule also requires formal acknowledgement from the consumer that disclosures were received.

In addition, to the extent practicable, a depository institution must keep insurance and annuity sales activities physically segregated from the areas where retail deposits are routinely accepted from the general public.

Regulation of the Bank

General. As a federally chartered, FDIC insured savings association, the Bank is subject to extensive regulation, examination, and supervision by the OTS, as its primary federal regulator, and the FDIC, as the insurer of customer deposits. Lending activities and other investments of the Bank must comply with various statutory and regulatory requirements. The Bank is also subject to certain reserve requirements promulgated by the Board of Governors of the Federal Reserve System ("FRB").

The OTS, in conjunction with the FDIC, regularly examines the Bank and prepares reports for the consideration of the Bank's Board of Directors on any deficiencies found in the operations of the Bank. The relationship between the Bank and depositors and borrowers is also regulated by federal and state laws, especially in such matters as the ownership of deposit accounts and the form and content of mortgage documents utilized by the Bank.

The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions such as mergers with or acquisitions of other financial institutions. This regulation and supervision establishes a comprehensive framework of activities in which an institution can engage and is intended primarily for the protection of the FDIC insurance funds and depositors.

The OTS and / or the FDIC conduct periodic examinations to test the Bank's safety and soundness, its operations (including technology utilization), and its compliance with applicable laws and regulations, including, but not limited to:

- the Community Reinvestment Act ("CRA")
- the Real Estate Settlement Procedures Act ("RESPA")
- the Bank Secrecy Act ("BSA")
- the Fair Credit Reporting Act ("FCRA")
- the Home Mortgage Disclosure Act ("HMDA")

The regulatory structure provides the regulatory authorities extensive discretion, in connection with their supervisory and enforcement activities and examination policies, across a wide range of the Bank's operations, including, but not limited to:

- loss reserve adequacy
- capital requirements
- credit classification
- limitation or prohibition on dividends
- assessment levels for deposit insurance and examination costs
- permissible branching

Any change in regulatory requirements and policies, whether by the OTS, the FDIC, the Federal Reserve Board, or Congress, could have a material adverse impact on the Company.

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Regulatory Capital Requirements And Capital Categories

The following discussion regarding regulatory capital requirements is applicable to the Bank.

Regulatory Capital Requirements. OTS capital regulations require savings institutions to meet three minimum capital standards (as defined by applicable regulations):

- tangible capital equal to 1.5% of adjusted total assets
- leverage capital (core capital) equal to 3.0% of adjusted total assets
- risk-based capital equal to 8.0% of total risk-based assets

The Bank must meet each of these three standards in order to be deemed in compliance with OTS capital requirements. The capital standard applicable to savings institutions must be no less stringent than those for national banks. In addition, the prompt corrective action ("PCA") standards discussed below also establish, in effect, the following minimum standards:

- a 2.0% tangible capital ratio
- a 4.0% leverage (core) capital ratio (3.0% for institutions receiving the highest regulatory rating under the CAMELS rating system)
- a 4.0% Tier One risk based capital ratio

Tangible capital is composed of:

- common stockholders' equity (including retained earnings)
- certain noncumulative perpetual preferred stock and related earnings
- minority interests in equity accounts of consolidated subsidiaries

less:

- intangible assets other than certain asset servicing rights and certain nonsecurity financial instruments
- investments in and loans or advances to subsidiaries engaged in activities as principal, not permissible for a national bank, with certain limited exceptions
- servicing assets in excess of certain thresholds
- deferred tax assets in excess of certain thresholds
- accumulated unrealized gains on certain available for sale securities
- accumulated gains related to qualifying cash flow hedges

plus:

- accumulated unrealized losses on certain available for sale securities
- accumulated losses related to qualifying cash flow hedges

Core capital consists of tangible capital plus various adjustments for certain intangible assets. At December 31, 2002, the Bank's tangible capital was equivalent to its core capital, as the Bank did not maintain any qualifying adjustments. In general, total assets calculated for regulatory capital purposes exclude those assets deducted from capital in determining the applicable capital ratio.

The risk based capital standard for savings institutions requires the maintenance of Tier One capital (core capital) and total capital (defined as core capital plus supplementary capital) to risk weighted assets of 4.0% and 8.0%, respectively. In determining the amount of an institution's risk weighted assets, all assets, including certain off balance sheet positions, are multiplied by a risk weight of 0.0% to 100.0%, as assigned by OTS regulations based upon the amount of risk perceived as inherent in each type of asset. The components of supplementary capital include:

- cumulative preferred stock
- long term perpetual preferred stock
- mandatory convertible securities
- certain subordinated debt
- intermediate preferred stock

- the general allowance for loan and lease losses, subject to a limit of 1.25% of risk weighted assets

Overall, the amount of supplementary capital included as part of total capital cannot exceed 100.0% of core capital.

These regulatory capital requirements are viewed as minimum standards by the OTS, and most institutions are expected to maintain capital levels well above the minimum. In addition, the OTS regulations provide that minimum capital levels higher than those provided in the regulations may be established by the OTS for individual savings associations, upon a determination that the savings association's capital is or may become inadequate in view of its circumstances. The OTS regulations provide that higher individual minimum regulatory capital requirements may be appropriate in circumstances where, among others:

- a savings association has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration of credit risk, certain risks arising from nontraditional activities, or similar risks or a high proportion of off-balance sheet risk;

- a savings association is growing, either internally or through acquisitions, at such a rate that supervisory problems are presented that are not dealt with adequately by OTS regulations; or

- a savings association may be adversely affected by activities or condition of its holding company, affiliates, subsidiaries, or other persons, or savings associations with which it has significant business relationships.

The Home Owners' Loan Act ("HOLA") permits savings associations not in compliance with the OTS capital standards to seek an exemption from certain penalties or sanctions for noncompliance. Such an exemption will be granted only if certain strict requirements are met, and must be denied under certain circumstances. If an exemption is granted by the OTS, the savings association still may be subject to enforcement actions for other violations of law or unsafe or unsound practices or conditions.

As disclosed in Note 14 to the Consolidated Financial Statements, at December 31, 2002, the Bank exceeded all minimum and institution specific regulatory capital requirements.

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Prompt Corrective Action Regulations. The OTS can levy sanctions against institutions that are not adequately capitalized, with the severity of the sanctions increasing as the institution's capital declines. The OTS has established specific capital ratios under the Prompt Corrective Action ("PCA") Regulations for five separate capital categories:

1. Well Capitalized	3. Under Capitalized
Total risk based capital ratio of at least 10.0%	Total risk based capital ratio of
Tier One risk based capital ratio of at least 6.0%	Tier One risk based capital ratio
Leverage ratio of at least 5.0%	Leverage ratio of less than 4.0%
2. Adequately Capitalized	4. Significantly Under Capitaliz

Total risk based capital ratio of at least 8.0%	Total risk based capital ratio of
Tier One risk based capital ratio of at least 4.0%	Tier One risk based capital ratio
Leverage ratio of at least 4.0%	Leverage ratio of less than 3.0%
	5. Critically Under Capitalized
	Tangible capital of less than 2.0

In general, the prompt corrective action regulation prohibits an insured depository institution from declaring any dividends, making any other capital distribution, or paying a management fee to a controlling person if, following the distribution or payment, the institution would be within any of the three undercapitalized categories. In addition, adequately capitalized institutions may accept brokered deposits only with a waiver from the FDIC and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew, or roll-over brokered deposits.

If the OTS determines that an institution is in an unsafe or unsound condition, or if the institution is deemed to be engaging in an unsafe and unsound practice, the OTS may, if the institution is well capitalized, reclassify it as adequately capitalized; if the institution is adequately capitalized but not well capitalized, require it to comply with restrictions applicable to undercapitalized institutions; and, if the institution is undercapitalized, require it to comply with certain restrictions applicable to significantly undercapitalized institutions. Finally, pursuant to an interagency agreement, the FDIC can examine any institution that has a substandard regulatory examination score or is considered undercapitalized - without the express permission of the institution's primary regulator.

As disclosed in Note 14 to the Consolidated Financial Statements, at December 31, 2002, the Bank met the requirements to be classified as a "well capitalized" institution under Prompt Corrective Action regulations. At December 31, 2002, the Bank was eligible to acquire brokered deposits.

Regulatory Capital Requirements Associated With Subprime Lending. As a result of a number of federally insured financial institutions extending their risk selection standards to attract lower credit quality accounts due to such credits having higher interest rates and fees, the federal banking regulatory agencies jointly issued Interagency Guidelines on Subprime Lending. Subprime lending involves extending credit to individuals with less than perfect credit histories.

The agencies' guidelines provide that if the risks associated with subprime lending are not properly controlled, the agencies consider subprime lending a high-risk activity that is unsafe and unsound. Specifically, the guidelines direct examiners to expect regulatory capital to be one and one-half to three times higher than that typically set aside for prime assets for institutions that:

- have subprime assets equal to 25% or higher of Tier 1 capital; or
- have subprime portfolios experiencing rapid growth or adverse performance trends, administered by inexperienced management, or having inadequate or weak controls.

The Bank does not normally engage in subprime lending.

Predatory Lending. The term "predatory lending", much like the terms "safety and soundness" and "unfair and deceptive practices," is far-reaching and covers a potentially broad range of behavior. As such, it does not lend itself to a concise or a comprehensive definition. But typically predatory lending involves at least one, and perhaps all three, of the following elements:

- making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation ("asset-based lending")
- inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced ("loan flipping")
- engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

On October 1, 2002, Federal Reserve Board regulations aimed at curbing predatory lending became effective. The rule significantly widens the pool of high-cost home-secured loans covered by the Home Ownership and Equity Protection Act of 1994 ("HOPEA"), a federal law that requires extra disclosures and consumer protections to borrowers. The following triggers coverage under HOPEA:

- interest rates for first lien mortgage loans in excess of 8 percentage points above comparable term Treasury securities;
- subordinate-lien loans of 10 percentage points above comparable term Treasury securities; or
- fees such as optional insurance and similar debt protection costs paid in connection with the credit transaction, when combined with points and fees if deemed excessive.

In addition, the regulation bars loan flipping by the same lender or loan servicer within a year. Lenders also will be presumed to have violated the law -- which says loans shouldn't be made to people unable to repay them -- unless they document that the borrower has the ability to repay. Lenders that violate the rules face cancellation of loans and penalties equal to the finance charges paid.

Because the Bank does not engage in the various practices generally referenced as "predatory lending", Management does not anticipate any material impact from these rule changes and potential state action in this area on its financial condition or results of operation.

Safety and Soundness Standards

The OTS has established minimum standards to promote early identification of management problems at depository institutions and to ensure that regulators intervene promptly to require corrective action by institutions with inadequate operational and managerial controls related to:

- internal controls, information systems, and internal audit systems
- loan documentation
- credit underwriting
- asset growth
- earnings
- interest rate risk exposure

o compensation, fees, and benefits

If the OTS determines that an institution fails to meet any of these minimum standards, the agency may require the institution to submit to the agency an acceptable plan to achieve compliance with the standard. In the event the institution fails to submit an acceptable plan within the time allowed by the agency or fails in any material respect to implement an accepted plan; the agency must, by order, require the institution to correct the deficiency and may implement a series of supervisory sanctions.

The federal banking agencies (including the OTS) have promulgated safety and soundness regulations and accompanying interagency compliance guidelines on asset quality and earnings standards. These guidelines provide six standards for establishing and maintaining a system to identify problem assets and prevent those assets from deteriorating. The institution should:

1. conduct periodic asset quality reviews to identify problem assets

2. estimate the inherent losses in those assets and establish reserves that are sufficient to absorb estimated losses

3. compare problem asset totals to capital

4. take appropriate corrective action to resolve problem assets

5. consider the size and potential risks of material asset concentrations

6. provide periodic asset reports with adequate information for management and the board of directors to assess the level of asset risk

These guidelines also set forth standards for evaluating and monitoring earnings and for ensuring that earnings are sufficient for the maintenance of adequate capital and reserves. If the institution fails to comply with a safety and soundness standard, the appropriate federal banking agency may require the institution to submit a compliance plan. Failure to submit a compliance plan or to implement an accepted plan may result in enforcement action.

Potential Enforcement Actions

The OTS has primary enforcement responsibility over savings institutions and maintains the authority to bring actions against the institution and all institution affiliated parties, as defined under the applicable regulations, for unsafe or unsound practices in conducting their businesses or for violations of any law, rule, regulation, condition imposed in writing by the agency, or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease and desist order that can be judicially enforced, the termination of insurance of deposits (in the case of the Bank), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the issuance of removal or prohibition orders against institution affiliated parties, and the imposition of restrictions under the PCA provisions of FDICIA. Federal law also establishes criminal penalties for certain violations.

Under the FDI Act, the FDIC has the authority to recommend to the Director of the OTS enforcement action to be taken with respect to a particular

savings institution. If action is not taken by the Director of the OTS, the FDIC has authority to take such action under certain circumstances.

Additionally, a holding company's inability to serve as a source of strength to its subsidiary financial institutions could serve as an ancillary basis for regulatory action against the holding company. Neither MBBC, the Bank, or any subsidiary thereof are currently subject to any enforcement actions

Insurance of Deposit Accounts

The Bank's deposit accounts are presently insured by the SAIF, except for certain acquired deposits that are insured by the BIF, up to the maximum permitted by law. The SAIF and the BIF are administered by the FDIC. Insurance of deposits may be terminated by the FDIC upon a finding that the institution:

- has engaged in unsafe or unsound practices;

- is in an unsafe or unsound condition to continue operations; or

- has violated any applicable law, regulation, rule, order, or condition imposed by the FDIC or the institution's primary regulator.

The management of the Bank does not know of any practice, condition, or violation that might lead to the termination of deposit insurance.

The FDIC currently assesses its premiums based upon the insured institution's position on two factors:

1. the institution's capital category under PCA regulations
2. the institution's supervisory category as determined by the FDIC based upon supervisory information provided by the institution's primary federal regulator and other information deemed pertinent by the FDIC

The supervisory categories are:

- Group A: financially sound with only a few minor weaknesses
- Group B: demonstrates weaknesses that could result in significant deterioration
- Group C: poses a substantial probability of loss

Annual FDIC deposit insurance assessment rates as of January 1, 2003 were as follows:

As Of January 1, 2003	FDIC Deposit Insurance Rates Expressed In Terms Of Annual Cents Per $100 of Assessed Deposits		
	Group A	Group B	Group C
PCA Capital Category			
Well capitalized	0	3	17
Adequately capitalized	3	10	24
Under capitalized	10	24	27

As of January 1, 2003, the Bank had been notified by the FDIC that its deposit insurance assessment rate during the first half of calendar 2002 would be 0 basis points.

In addition to the deposit insurance premiums presented in the above table, both BIF and SAIF insured institutions must also pay FDIC premiums related to the servicing of Financing Corporation ("FICO") bonds. FICO is an agency of the federal government that was established to recapitalize the predecessor to the SAIF. These assessments will continue until the FICO bonds mature in 2017. The current annual assessment rate for the FICO bonds is approximately 2 basis points per annum on insured deposits.

In early 2003, Congress was considering various new laws applicable to FDIC insurance premiums and insurance coverage. See "Potential Federal Legislation and Regulation".

Branching

OTS regulations permit nationwide branching by federally chartered savings institutions to the extent allowed by federal statute. This permits federal savings institutions to establish interstate networks and to geographically diversify their loan portfolios and lines of business. The OTS authority preempts any state law purporting to regulate branching by federal savings institutions. At this time, the Company's management has no plans to establish physical branches outside of California, although the Bank does serve customers domiciled outside of California via alternative delivery channels such as telephone, mail, the Internet, and ATM networks.

Transactions With Related Parties

Transactions between a savings association and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act and by FRB Regulation W. Affiliates of a savings association include, among other entities, the savings association's holding company and companies that are under common control with the savings association. In general, a savings association or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates:

- to an amount equal to 10% of the association's capital and surplus, in the case of covered transactions with any one affiliate; and

- to an amount equal to 20% of the association's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a savings association and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the savings association or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A "covered transaction" includes:

- a loan or extension of credit to an affiliate

- a purchase of investment securities issued by an affiliate

- a purchase of assets from an affiliate, with some exceptions

- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party

- the issuance of a guarantee, acceptance, or letter of credit on behalf of an affiliate

In addition, under the OTS regulations:

- a savings association may not make a loan or extension of credit to an affiliate unless the affiliate is engaged only in activities permissible for bank holding companies;
- a savings association may not purchase or invest in securities of an affiliate other than shares of a subsidiary;
- a savings association and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a savings association or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a savings association to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

OTS regulations generally exclude all non-bank and non-savings association subsidiaries of savings associations from treatment as affiliates, except for:

- a financial subsidiary
- a subsidiary controlled by one or more affiliates
- an ESOP
- a subsidiary determined by the OTS or the Federal Reserve to be an affiliate

The regulations also require savings associations to make and retain records that reflect affiliate transactions in reasonable detail and provides that specified classes of savings associations may be required to give the OTS prior notice of affiliate transactions.

The Bank's authority to extend credit to executive officers, directors, and 10% shareholders, ("insiders"), as well as entities such persons control, is governed by the Federal Reserve Act and Regulation O thereunder. Among other things, such loans are required to be made on terms substantially the same as those offered to unaffiliated individuals and to not involve more than the normal risk of repayment. Specific legislation created an exception for loans made pursuant to a benefit or compensation program that is widely available to all employees of the institution and does not give preference to insiders over other employees. Regulation O also places individual and aggregate limits on the amount of loans the Bank may make to insiders based, in part, on the Bank's capital position and requires certain Board approval procedures to be followed. For information concerning loans to executive officers and directors of the Company, please refer to Note 5 to the Consolidated Financial Statements.

Community Reinvestment Act and Fair Lending Laws

Savings associations have a responsibility under the Community Reinvestment Act ("CRA") and related regulations of the OTS to help meet the credit needs of their communities. The CRA generally requires most insured depository institutions to:

- identify and delineate the communities served through and by the institution's offices
- affirmatively meet the credit needs of their delineated communities, including low and moderate income neighborhoods
- market the types of credit the institution is prepared to extend within such communities

The CRA requires the OTS to assess the performance of the institution in meeting the credit needs of its communities and to take such assessment into consideration in reviewing applications for mergers, acquisitions, and other transactions. An unsatisfactory CRA rating may be the basis for denying such an application. In addition, federal banking agencies may take compliance with CRA into account when regulating and supervising other activities.

The Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. In addition, an institution's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in the OTS, other federal regulatory agencies, or the Department of Justice taking enforcement actions.

An institution's CRA performance is assessed on the basis of the institution's actual lending, service, and investment performance. In connection with its assessment of the Bank's CRA performance, the OTS assigns one of the following ratings:

- outstanding
- satisfactory
- needs improvement
- substantial noncompliance

Based upon its most recent CRA examination, the Bank received a "satisfactory" CRA rating.

Effective January 1, 2002, the OTS raised the dollar amount limit in the definition of small business loans from $500,000 to $2.0 million, if used for commercial, corporate, business, or agricultural purposes. Furthermore, the rule raises the aggregate level that a thrift can invest directly in community development funds, community centers, and economic development initiatives in its communities from the greater of a quarter of one percent of total capital or $100,000 to one percent of total capital or $250,000.

Qualified Thrift Lender Test

The HOLA requires savings associations to meet a qualified thrift lender ("QTL") test. A savings association is permitted to meet the QTL test in one of two alternative ways. Under the first method, in at least nine out of every twelve months, the thrift institution is required to maintain at least 65% of its "portfolio assets," defined as total assets less (i) specified liquid assets up to 20% of total assets, (ii) intangible assets, including goodwill and (iii) the value of property used to conduct business, in certain "qualified thrift investments." Assets constituting qualified thrift investments include residential mortgages, qualifying mortgage backed securities, educational loans, small business loans, and credit card loans. Certain other types of assets also qualify as "qualified thrift investments" up to certain limitations. These limited other types of assets include home equity lines of credit and consumer loans. Alternatively, savings institutions are permitted to meet the QTL test by qualifying as a "domestic building and loan association" under the Internal Revenue Code by meeting the Code's 60% of assets test in nine out of every twelve months.

Savings associations that fail to meet the QTL test will generally be prohibited from engaging in any activity not permitted for both a national bank and a savings association. A savings association that fails the QTL test may be required to convert to a commercial bank charter. At December 31, 2002, the Bank maintained 68.4% of its portfolio assets in qualified thrift investments and, therefore, met the QTL test.

Loans To One Borrower Limitations

Savings associations generally are subject to the lending limits applicable to national banks. With certain limited exceptions, the maximum amount that a savings association or a national bank may lend to any borrower (including certain related entities of the borrower) at one time may not exceed 15% of the unimpaired capital and surplus of the institution, plus an additional 10% of unimpaired capital and surplus for loans fully secured by readily marketable collateral. The term "unimpaired capital and surplus" is defined as an institution's regulatory capital, plus that portion of an institution's general valuation allowances that is not includable in the institution's regulatory capital. "Readily marketable collateral" is defined to include certain financial instruments and specifically excludes real estate.

Savings associations are additionally authorized to make loans to one borrower, for any purpose, in an amount not to exceed $500,000 or, by order of the Director of OTS, in an amount not to exceed the lesser of $30,000,000 or 30% of unimpaired capital and surplus to develop residential housing, provided:

- the purchase price of each single-family dwelling in the development does not exceed $500,000;
- the savings association is in compliance with its regulatory capital requirements;
- the loans comply with applicable loan-to-value requirements; and
- the aggregate amount of loans made under this authority does not exceed 150% of unimpaired capital and surplus.

At December 31, 2002, the Bank's limit on loans to one borrower was $9.0 million. At December 31, 2002, the Bank's largest aggregate outstanding

balances of loans to one borrower were:

- a $7.5 million construction loan for the development of an apartment building in Los Angeles, California
- a $7.0 million construction loan for a residential development in Soledad, California
- a total of $6.9 million in aggregate loans associated with an upscale residential development in Monterey, California

At December 31, 2002, all of the above loans were performing in accordance with their terms. The Bank has conducted lending in the Monterey residential development for the past several years.

Limitations On Capital Distributions

OTS regulations impose limitations upon all capital distributions by savings institutions, such as cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of another institution in a cash-out merger, and other distributions charged against capital. Under current regulations, a savings association in some circumstances may:

- be required to file an application and await approval from the OTS before it makes a capital distribution
- be required to file a notice 30 days before the capital distribution
- be permitted to make the capital distribution without notice or application to the OTS

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The OTS regulations require a savings association to file an application if:

- it is not eligible for expedited treatment of its other applications under OTS regulations
- the total amount of all of capital distributions, including the proposed capital distribution, for the applicable calendar year exceeds its net income for that year to date plus retained net income for the preceding two years
- it would not be at least adequately capitalized, under the prompt corrective action regulations of the OTS, following the distribution
- the association's proposed capital distribution would violate a prohibition contained in any applicable statute, regulation, or agreement between the savings association and the OTS, or the FDIC, or violate a condition imposed on the savings association in an OTS-approved application or notice

In addition, a savings association must give the OTS notice of a capital distribution if the savings association is not required to file an application, but:

- would not be well capitalized under the prompt corrective action regulations of the OTS following the distribution

- the proposed capital distribution would reduce the amount of or retire any part of the savings association's common or preferred stock or retire any part of debt instruments like notes or debentures included in capital, other than regular payments required under a debt instrument approved by the OTS

- the savings association is a subsidiary of a savings and loan holding company (applicable to the Bank)

The OTS may prohibit a proposed capital distribution that would otherwise be permitted if the OTS determines that the distribution would constitute an unsafe or unsound practice. Further, a federal savings association, like the Bank, cannot distribute regulatory capital that is needed for its liquidation account.

The Bank did not declare or pay any dividends to MBBC in 2001 or 2002.

Activities of Subsidiaries

A savings association seeking to establish a new subsidiary, acquire control of an existing company or conduct a new activity through a subsidiary must provide 30 days prior notice to the FDIC and the OTS and conduct any activities of the subsidiary in compliance with regulations and orders of the OTS. The OTS has the power to require a savings association to divest any subsidiary or terminate any activity conducted by a subsidiary that the OTS determines to pose a serious threat to the financial safety, soundness, or stability of the savings association or to be otherwise inconsistent with sound banking practices.

Restrictions On Investments And Loans

OTS regulations do not permit the Bank to invest directly in equity securities (with certain very limited exceptions), non investment grade debt securities, or real estate, other than real estate used for the institution's offices and facilities. Indirect equity investment in real estate through a subsidiary, such as Portola, is permissible, but is subject to certain limitations and deductions from regulatory capital. Management has no plans to pursue real estate development or real estate investment activity through Portola.

The OTS and other federal banking agencies have jointly adopted uniform rules on real estate lending and related Interagency Guidelines for Real Estate Lending Policies (the "Guidelines"). The uniform rules require that institutions adopt and maintain comprehensive written policies for real estate lending. The policies must reflect consideration of the Guidelines and must address relevant lending procedures, such as loan to value limitations, loan administration procedures, portfolio diversification standards and documentation, and approval and reporting requirements. Although the uniform rules do not impose specific maximum loan to value ratios, the related Guidelines state that such ratio limits established by an individual institution's board of directors generally should not exceed levels set forth in the Guidelines, which range from a maximum of 65% for loans secured by unimproved land to 85% for improved property. No limit is set for single family residential mortgages, but the Guidelines state that such loans equal to or exceeding a 90.0% loan to value ratio should have

private mortgage insurance or some other form of credit enhancement. The Guidelines further permit a limited amount of loans that do not conform to these criteria. In addition, aggregate loans secured by non-residential real property are generally limited to 400% of a thrift institution's total capital, as defined.

Classification Of Assets

Thrift institutions are required to classify their assets on a regular basis, to establish appropriate allowances for losses, and to report the results of such classifications quarterly to the OTS. A thrift institution is also required to set aside adequate valuation allowances, and to establish liabilities for off balance sheet items, such as letters of credit, when loss becomes probable and estimable. The OTS has the authority to review the institution's classification of its assets and to determine whether and to what extent (i) additional assets must be classified, and (ii) whether the institution's allowances must be increased. Such instruction by the OTS to increase valuation allowances could have a material impact upon both the Company's reported earnings and its financial condition.

The OTS and the other federal banking regulatory agencies have adopted an interagency policy statement regarding the appropriate levels of valuation allowances for loan and lease losses that insured depository institutions should maintain. Under this policy statement, examiners will generally accept management's evaluation of the adequacy of valuation allowances if the institution has:

- maintained effective systems and controls for identifying and addressing asset quality problems
- analyzed in a reasonable manner all significant factors that affect the collectibility of the portfolio
- established an acceptable process for evaluating the adequacy of valuation allowances

However, the policy statement also provides that OTS examiners will review management's analysis more closely if valuation allowances do not at least equal the following benchmarks:

- 15% of assets classified as substandard
- 50% of assets classified as doubtful
- for the portfolio of unclassified loans and leases, an estimate of credit losses over the upcoming twelve months based upon the institution's recent average rate of net charge-offs on similar loans, adjusted for current trends and conditions

The Company's internal credit policy is to comply with the interagency policy statement and to maintain adequate reserves for estimable losses. However, the determination of estimable losses is by nature an uncertain practice, and hence no assurance can be given that the Company's loss allowances will prove adequate to cover future losses.

Assessments

Thrift institutions are required to pay assessments to the OTS to fund the agency's operations. The general assessment, paid on a semi-annual basis, is computed based upon a three component equation. The components are total assets, regulatory rating, and amount and nature of off balance sheet activities. The Bank's general assessment for the six month period commencing January 2003 was $61 thousand. The general assessments paid by the Bank for the fiscal year ended December 31, 2002 totaled $114 thousand.

Federal Home Loan Bank ("FHLB") System

The Bank is a member of the Federal Home Loan Bank of San Francisco ("FHLB-SF"). Each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned geographic region. Each Federal Home Loan Bank is financed primarily from the sale of consolidated obligations of the FHLB system. The FHLB-SF provides a comprehensive credit facility and various correspondent services to member institutions. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB. As a member of the FHLB-SF, the Bank is required to own capital stock in an amount at least equal to the greater of:

- 1.0% of the aggregate principal amount of outstanding residential loans and mortgage backed securities, as defined, at the beginning of each calendar year

- 5.0% of its advances from the FHLB

At its most recent evaluation, the Bank was in compliance with this requirement. FHLB advances must be secured by specific types of collateral, including various types of mortgage loans and securities, and the Bank's investment in the capital stock of the FHLB. It is the policy of the Bank to maintain an excess of pledged collateral with the FHLB-SF at all times to serve as a ready source of additional liquidity.

The FHLB's are required to provide funds to contribute toward the payment of certain bonds issued in the past to fund the resolution of insolvent thrifts. In addition, FHLB's are required by statute to contribute funds toward affordable housing programs. These requirements could reduce the amount of dividends the FHLB's pay on their capital stock and could also negatively impact the pricing offered for on and off balance sheet credit products - events that could unfavorably impact the profitability of the Company.

The Gramm-Leach-Bliley Act made significant reforms to the FHLB system, including:

- Expanded Membership - (i) expands the uses for, and types of, collateral for advances; (ii) eliminates bias toward QTL lenders; and (iii) removes capital limits on advances using real estate related collateral (e.g., commercial real estate and home equity loans)

- New Capital Structure - each FHLB is allowed to establish two classes of stock: Class A is redeemable within six months of notice; and Class B is redeemable within five years notice. Class B is valued at 1.5 times the value of Class A stock. Each FHLB will be required to maintain minimum capital equal to 5% of equity.

- Voluntary Membership - federally chartered savings associations, such as the Bank, are no longer required to be members of the system.

- REFCorp Payments - changes the amount paid by the system on debt incurred

in connection with the thrift crisis in the late 1980s from a fixed amount to 20% of net earnings after deducting certain expenses.

The new capital plan of the FHLB-SF was approved by the Federal Housing Finance Board on June 12, 2002. The FHLB-SF has not yet established an implementation date for the new capital plan, with such implementation required by June 2005. The Bank will receive at least 240 days' written notice of the implementation date. The new capital plan incorporates a single class of stock and requires each member to own stock in amount equal to the greater of:

- a membership stock requirement, or
- an activity based stock requirement

The new capital stock is redeemable on five years' written notice, subject to certain conditions.

The Company does not believe that the initial implementation of the FHLB-SF new capital plan as approved will have a material impact upon our financial condition, cash flows, or results of operations. However, the Bank could be required to purchase as much as 50% additional capital stock or sell as much as 50% of its proposed capital stock requirement at the discretion of the FHLB-SF.

Federal Reserve System

The FRB requires insured depository institutions to maintain non-interest-earning ("sterile") reserves against certain of their transactional accounts (primarily deposit accounts that may be accessed by writing unlimited checks). At December 31, 2002, the regulations generally required that reserves be maintained against qualified net transaction accounts as follows:

First $6.0 million	Exempt
Next $36.1 million	3.0%
Amount above $42.1 million	10.0%

The reserve requirement may be met by certain qualified cash balances. For the calculation period including December 31, 2002, the Bank was in compliance with its FRB reserve requirements. As a creditor and an insured depository institution, the Bank is subject to certain regulations promulgated by the FRB, including, but not limited to:

Regulation B	Equal Credit Opportunity Act	Regulation P	Privacy Of Consumer Fin
Regulation C	Home Mortgage Disclosure Act	Regulation X	Real Estate Settlement
Regulation D	Reserve Requirements	Regulation W	Transactions With Affil
Regulation E	Electronic Funds Transfers Act	Regulation Z	Truth In Lending Act
Regulation F	Limits On Interbank Liabilities	Regulation CC	Expedited Funds Availab
Regulation O	Extensions Of Credit To Insiders	Regulation DD	Truth In Savings Act

On January 9, 2003, the FRB modified its discount window programs to encourage borrowings from financial institutions and for financial institutions to more readily utilize the discount window programs as an additional source of liquidity.

Potential Federal Legislation and Regulation

The US Congress continues to consider a broad range of legislative initiatives that might impact the financial services industry. Among these initiatives are:

- the potential merger of the BIF and SAIF insurance funds of the FDIC

- the elimination of fixed minimum reserve ratios for the FDIC insurance funds in favor an expanded range

- potential FDIC deposit insurance reforms, including an increase in the amount of coverage, indexing of coverage limits for inflation, changes in coverage for certain deposits, and modifications in the assessment formula for FDIC insurance, perhaps to include granting the FDIC greater latitude in setting deposit insurance premium rates including a greater consideration of risk-based premiums

- the potential for insured depository institutions to pay interest on business checking deposits, perhaps in conjunction with authorization for the Federal Reserve to pay interest on sterile reserves

- the potential relaxation of transaction count restrictions on money market demand deposits, thereby facilitating internal fund "sweeps" (of particular benefit to smaller financial institutions such as the Bank)

- possible modifications in federal bankruptcy laws, including potential revisions that would encourage Chapter 13 filings (with payment requirements) versus Chapter 7 filings (debt forgiveness)

US financial institution regulatory agencies were considering at December 31, 2002 a series of potential regulatory changes or additions, including:

- increased information reporting requirements under Regulation C

- enhanced enforcement procedures associated with Regulation X

- expanded investment powers for federally chartered credit unions

- revisions to bank regulatory capital requirements

- modifications to CRA compliance rules

- revisions in required financial reporting, including a proposal by the OTS to accelerate filing deadlines for regulatory reports

The Company cannot predict what legislation and regulation, if any, might emerge from Congress and the various federal regulatory agencies, and the potential impact of such legislation and regulation upon the Company.

Environmental Regulation

The Company's business and properties are subject to federal and state laws and regulations governing environmental matters, including the regulation of hazardous substances and wastes. For example, under the federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") and similar state laws, owners and operators of contaminated properties may be liable for the costs of cleaning up hazardous substances without regard to whether such persons actually caused the contamination. Such laws may affect the Company as an owner or operator of properties used in its business, and through the Bank, as a secured lender of property that is found to contain hazardous substances or wastes.

Although CERCLA and similar state laws generally exempt holders of security interests, the exemption may not be available if a secured party engages in the management of its borrower or the securing property in a manner deemed beyond the protection of the secured party's interest. Recent federal and state legislation, as well as guidance issued by the United State Environmental Protection Agency and a number of court decisions, have provided assurance to lenders regarding the activities they may undertake and remain within CERCLA's secured party exemption. However, these assurances are not absolute and generally will not protect a lender or fiduciary that participates or otherwise involves itself in the management of its borrower, particularly in foreclosure proceedings. As a result, CERCLA and similar state statutes may influence the Bank's decision whether to foreclose on property that may be or is found to be contaminated. The Bank has adopted environmental underwriting requirements for commercial and industrial real estate loans. The Bank's general policy is to obtain an environmental assessment prior to foreclosure on commercial and industrial real estate. See "Business - General" and "Lending Activities - Loan Portfolio Composition" regarding the recent expansion in the Bank's commercial and industrial real estate loan portfolio. The existence of hazardous substances or wastes on commercial and industrial real estate properties could cause the Bank to elect not to foreclose on the property, thereby limiting, and in some cases precluding, the Bank from realizing on the related loan. Should the Bank foreclose on property containing hazardous substances or wastes, the Bank could become subject to other environmental statutes, regulations, and common law relating to matters such as, but not limited to, asbestos abatement, lead-based paint abatement, hazardous substance investigation and remediation, air emissions, wastewater discharges, hazardous waste management, and third party claims for personal injury and property damage.

Federal Securities Laws

The Company's common stock is registered with the SEC under Section 12(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Company is subject to periodic reporting requirements, proxy solicitation rules, insider trading restrictions, tender offer rules, and corporate governance and other requirements under the Exchange Act. In addition, certain activities of the Company, its executive officers, and directors are covered under the Securities Act of 1933, as amended (the "Securities Act").

Non-Banking Regulation

The Company is impacted by many other laws and regulations, not necessarily unique to insured depository institutions. Among these other laws and regulations are federal bankruptcy laws and requirements of the Nasdaq National Market System.

Federal Taxation

General. The Bank and the Company report their income on a consolidated basis using the accrual method of accounting and will be subject to federal income taxation in the same manner as other corporations with some exceptions, including particularly the Bank's reserve for bad debts discussed below. The following discussion of tax matters is intended only as a summary and does not purport to be a comprehensive description of the tax rules applicable to the Bank or the Company. The Bank has not been audited by the IRS during the last five years. For its 2002 taxable year, the Bank is subject to a maximum federal income tax rate of 35%.

Bad Debt Reserve. For fiscal years beginning prior to December 31, 1995, thrift institutions which qualified under certain definitional tests and other conditions of the Internal Revenue Code of 1986 (the "Code") were permitted to use certain favorable provisions to calculate their deductions from taxable income for annual additions to their bad debt reserve. A reserve could be established for bad debts on qualifying real property loans (generally secured by interests in real property improved or to be improved) under (i) the Percentage of Taxable Income Method (the "PTI Method") or (ii) the Experience Method. The reserve for nonqualifying loans was computed using the Experience Method.

The Small Business Job Protection Act of 1996 (the "1996 Act"), which was enacted on August 20, 1996, requires savings institutions to recapture (i.e., take into income) certain portions of their accumulated bad debt reserves. The 1996 Act repeals the reserve method of accounting for bad debts effective for tax years beginning after 1995. Thrift institutions that would be treated as small banks are allowed to utilize the Experience Method applicable to such institutions, while thrift institutions that are treated as large banks (those generally exceeding $500 million in assets) are required to use only the specific charge-off method. Thus, the PTI Method of accounting for bad debts is no longer available for any financial institution.

A thrift institution required to change its method of computing reserves for bad debts will treat such change as a change in method of accounting, initiated by the taxpayer, and having been made with the consent of the IRS. Any Section 481 (a) adjustment required to be taken into income with respect to such change generally will be taken into income ratably over a six-taxable year period, beginning with the first taxable year beginning after 1995, subject to the residential loan requirement.

Under the residential loan requirement provision, the recapture required by the 1996 Act will be suspended for each of two successive taxable years, beginning with the Bank's current taxable year, in which the Bank originates a minimum of certain residential loans based upon the average of the principal amounts of such loans made by the Bank during its six taxable years preceding its current taxable year.

Under the 1996 Act, for its current and future taxable years, the Bank is permitted to make additions to its tax bad debt reserves. In addition, the Bank is required to recapture (i.e., take into income) over a six year period the excess of the balance of its tax bad debt reserves as of December 31, 1995 over the balance of such reserves as of December 31, 1987. The Bank completed this recapture in 2001.

Distributions. Under the 1996 Act, if the Bank makes "non-dividend distributions" to the Company, such distributions will be considered to have been made from the Bank's unrecaptured tax bad debt reserves (including the balance of its reserves as of December 31, 1987) to the extent thereof, and then

from the Bank's supplemental reserve for losses on loans, to the extent thereof, and an amount based on the amount distributed (but not in excess of the amount of such reserves) will be included in the Bank's income. Non-dividend distributions include distributions in excess of the Bank's current and accumulated earnings and profits, as calculated for federal income tax purposes, distributions in redemption of stock, and distributions in partial or complete liquidation. Dividends paid out of the Bank's current or accumulated earnings and profits will not be so included in the Bank's income.

The amount of additional taxable income triggered by a non-dividend is an amount that, when reduced by the tax attributable to the income, is equal to the amount of the distribution. Thus, if the Bank makes a non-dividend distribution to the Company, approximately one and one-half times the amount of such distribution (but not in excess of the amount of such reserves) would be includable in income for federal income tax purposes, assuming a 35% federal corporate income tax rate. The Bank does not intend to pay dividends that would result in a recapture of any portion its bad debt reserves.

Corporate Alternative Minimum Tax. The Internal Revenue Code of 1986, as amended (the "Code") imposes a tax on alternative minimum taxable income ("AMTI") at a rate of 20%. The excess of the bad debt reserve deduction using the percentage of taxable income method over the deduction that would have been allowable under the experience method is treated as a preference item for purposes of computing the AMTI. Only 90% of AMTI can be offset by net operating loss carryovers of which the Bank currently has none. AMTI is increased by an amount equal to 75% of the amount by which the Bank's adjusted current earnings exceeds its AMTI (determined without regard to this preference and prior to reduction for net operating losses). In addition, for taxable years beginning after December 31, 1986 and before January 1, 1996, an environmental tax of 0.12% of the excess of AMTI (with certain modifications) over $2.0 million is imposed on corporations, including the Company, whether or not an Alternative Minimum Tax ("AMT") is paid. The Bank does not expect to be subject to the AMT, but may be subject to the environmental tax liability.

Dividends Received Deduction and Other Matters. The Company may exclude from its income 100% of dividends received from the Bank as a member of the same affiliated group of corporations. The corporate dividends received deduction is generally 70% in the case of dividends received from unaffiliated corporations with which the Company and the Bank will not file a consolidated tax return, except that if the Company or the Bank own more than 20% of the stock of a corporation distributing a dividend then 80% of any dividends received may be deducted.

State and Local Taxation

State of California. The California franchise tax rate applicable to the Bank equals the franchise tax rate applicable to corporations generally, plus an "in lieu" rate approximately equal to personal property taxes and business license taxes paid by such corporations (but not generally paid by banks or financial corporations such as the Bank); however, the total tax rate cannot exceed 10.84%.

In 2002, California adopted conformity with many federal tax regulations, including in regards to bad debt deductions. MBBC, the Bank, and Portola file California State franchise tax returns on a consolidated basis. MBBC, as a savings and loan holding company commercially domiciled in

California, is treated as a financial corporation and subject to the general corporate tax rate plus the "in lieu" rate as discussed previously for the Bank.

The Company is headquartered in a State of California Enterprise Zone. In addition, the Bank's Watsonville branch is also located in an Enterprise Zone and the Bank extends credit to businesses located in a number of Enterprise Zones located throughout California. These attributes make the Bank eligible for certain additional State tax credits and deductions.

Please refer to Note 13 to the Consolidated Financial Statements for additional information regarding income taxes.

Delaware Taxation. As a Delaware holding company not earning income in Delaware, MBBC is exempted from Delaware corporate income tax but is required to file an annual report with and pay an annual franchise tax to the State of Delaware. Franchise tax expense for the State of Delaware totaled $55 thousand in 2002.

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Additional Item. Executive Officers of the Registrant

The following table sets forth certain information with respect to each executive officer of the Company or Bank who is not also a director of the Company. The Board of Directors appoints or reaffirms the appointment of all of the Company's executive officers each year. Each executive officer serves until the following year or until a respective successor is appointed.

Name	Age At 12/31/02	Position(s) With Company And / Or Bank	Date Started In Position	Previous Exper Than Five Year
Carlene F. Anderson	50	Assistant Corporate Secretary Monterey Bay Bancorp, Inc.	6/11/1999	Corporate Secr Monterey Bay B 1994 - 1999
		Assistant Corporate Secretary Vice President, Compliance Monterey Bay Bank.	6/11/1999 8/15/1998	Corporate Secr Monterey Bay B 1994 - 1999
Mark R. Andino	43	Chief Financial Officer Treasurer Monterey Bay Bancorp, Inc.	1/26/2000	Treasurer Chela Financia 1999
		Senior Vice President Chief Financial Officer Treasurer Monterey Bay Bank	1/26/2000	Senior Vice Pr Chief Financia HF Bancorp, In Hemet Federal 1996 - 1999
Susan M. Carlson	50	Senior Vice President Chief Administrative Officer Monterey Bay Bank	6/28/2001	Principal C&S Carlson En Financial Inst 1996 - 2001 Vice President Director of Ma

				American Bank, 1981 - 1996
Mary Anne Carson	35	Corporate Secretary Monterey Bay Bancorp, Inc.	5/9/2001	Vice President Assistant To T Coast Commerci
		Corporate Secretary Vice President Director Of Community Relations Monterey Bay Bank	5/9/2001	1996 - 2001
Elaine Genevro	51	Senior Vice President Director Of Retail Banking Monterey Bay Bank President Portola Investment Corporation	2/3/2003	Senior Vice Pr Regional Manag Bay View Bank 1997 - 2002
Joni James	47	Senior Vice President Director Of Information Technology	9/10/2001	Information Te BYL Group 1999 - 2001
David E. Porter	53	Senior Vice President Director of Commercial Banking Monterey Bay Bank	10/30/2000	Executive Vice Chief Credit O Southern Pacif 1996 - 2000
Ben A. Tinkey	50	Senior Vice President Chief Loan Officer Director of Real Estate Lending Monterey Bay Bank	9/20/1994	

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Item 2. Properties.

The following table sets forth information relating to each of the Company's offices and stand alone ATM locations as of December 31, 2002:

Location	Lease Or Owned	Original Date Leased or Acquired	Date of Lease Expiration
Administrative Offices:			
15 Brennan Street Watsonville, California 95076	Owned	12-31-65	N/A
567 Auto Center Drive Watsonville, California 95076 (Headquarters And Limited Service Branch Facility)	Owned	03-23-98	N/A
Full Service Branch Offices:			
35 East Lake Avenue Watsonville, California 95076	Owned	12-31-65	N/A
805 First Street			

Gilroy, California 95020	Owned	12-01-76	N/A
1400 Munras Avenue Monterey, California 93940	Owned	07-07-93	N/A
1890 North Main Street Salinas, California 93906	Owned	07-07-93	N/A
1127 South Main Street Salinas, California 93901	Leased	08-08-93	06-30-05
8071 San Miguel Canyon Road Prunedale, California 93907	Leased	12-24-93	12-31-03
601 Bay Avenue Capitola, California 95020	Owned	12-10-96	N/A
6265 Highway 9 Felton, California 95018	Leased	05-01-98	04-30-03
Loan Production Office:			
6080 Center Drive 6th Floor Los Angeles, CA. 90045	Leased	02-01-02	Month To Month

Stand Alone ATM's:	Agreement Commencement	Agreement Expiration
601 Wave Street Monterey, California 93940	4/11/00	4/10/03
104 Stockton Street Capitola, California 95010	9/1/97	3/31/04

Item 3. Legal Proceedings.

From time to time, the Company is party to claims and legal proceedings in the ordinary course of business. Management believes that the ultimate aggregate liability represented thereby, if any, will not have a material adverse effect on the Company's consolidated financial position or results of operations.

Item 4. Submission of Matters to a Vote of Security Holders.

No matter was submitted during the quarter ended December 31, 2002 to a vote of Monterey Bay Bancorp, Inc.'s security holders through the solicitation of proxies or otherwise.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Common Stock of Monterey Bay Bancorp, Inc. is traded on the NASDAQ National Market under the symbol "MBBC." The stock commenced trading on February

15, 1995, when the Company went public and sold 4,492,085 shares at a price of $6.40 per share (adjusted for a 5:4 stock split on July 31, 1998).

As of March 20, 2003, there were 3,460,974 shares of the Company's common stock outstanding. As of February 28, 2003, there were 263 stockholders of record, not including persons or entities who hold their stock in nominee or "street" name.

The following table sets forth the high and the low daily closing prices of the Company's common stock for each of the following calendar quarters.

	High	Low
Year Ended December 31, 2002:		
Fourth quarter	$ 20.000	$ 17.250
Third quarter	$ 18.470	$ 16.600
Second quarter	$ 19.450	$ 16.730
First quarter	$ 17.000	$ 15.300
Year Ended December 31, 2001:		
Fourth quarter	$ 15.500	$ 12.750
Third quarter	$ 16.500	$ 11.400
Second quarter	$ 11.970	$ 9.750
First quarter	$ 11.875	$ 10.000

The Company did not pay any cash dividends in 2002 or 2001. The Board of Directors has indefinitely suspended the declaration and payment of cash dividends in favor of alternative uses for the Company's capital and liquidity.

The Company is subject to certain restrictions and limitations on the payment of dividends pursuant to existing and applicable laws and regulations (see "Item 1. Business - Regulation And Supervision - Limitation On Capital Distributions" and Note 14 to the Consolidated Financial Statements).

Item 6. Selected Financial Data.

Set forth below are selected consolidated financial and other data of the Company for the periods and the dates indicated. This financial data is derived in part from, and should be read in conjunction with, the Consolidated Financial Statements and related Notes of the Company presented elsewhere herein. All per share information has been adjusted to reflect a five for four stock split distributed to stockholders of record in July 1998.

	At December 31,		
	2002	2001	2000
	(Dollars In Thousa		
Selected Financial Condition Data:			
Total assets	$ 609,696	$ 537,391	$ 486,190

Investment securities available for sale	7,030	7,300	7,360
Mortgage backed securities available for sale	37,466	30,644	42,950
Mortgage backed securities held to maturity	--	--	--
Loans receivable held for investment, net	521,929	465,887	391,820
Loans held for sale	1,545	713	--
Allowance for loan losses	8,162	6,665	5,364
Bank owned life insurance	9,036	--	--
Deposits	458,334	432,339	407,788
FHLB advances	93,582	53,582	32,582
Securities sold under agreements to repurchase	--	--	--
Stockholders' equity	56,103	50,162	43,837
Non-performing loans	2,643	2,252	4,741
Real estate acquired by foreclosure, net	846	--	--

	For The Year Ended Decembe		
	2002	2001	2000
	(Dollars In Thousands, Excep		
Selected Operating Data:			
Interest and dividend income	$ 35,486	$ 38,731	$ 37,757
Interest expense	12,907	18,990	19,777
Net interest income before provision for loan losses	22,579	19,741	17,980
Provision for loan losses	1,510	1,400	2,175
Net interest income after provision for loan losses	21,069	18,341	15,805
Non-interest income	2,127	2,566	2,340
Non-interest expense	13,780	14,369	13,676
Income before provision for income taxes	9,416	6,538	4,469
Provision for income taxes	3,778	2,787	1,946
Net income	$ 5,638	$ 3,751	$ 2,523
Shares applicable to basic earnings per share	3,369,600	3,275,303	3,110,910
Basic earnings per share	$ 1.67	$ 1.15	$ 0.81
Shares applicable to diluted earnings per share	3,497,150	3,343,233	3,123,552
Diluted earnings per share	$ 1.61	$ 1.12	$ 0.81
Cash dividends per share	$ --	$ --	$ 0.08

	At Or For The Year Ended Dece		
	2002	2001	2000

	----	----	----
Selected Financial Ratios and Other Data (1):			
Performance Ratios			
Return on average assets (2)	1.00%	0.73%	0.53%
Return on average stockholders' equity (3)	10.50%	7.94%	6.24%
Average stockholders' equity to average assets	9.55%	9.16%	8.52%
Stockholders' equity to total assets at end of period	9.20%	9.33%	9.02%
Interest rate spread during the period (4)	3.96%	3.67%	3.54%
Net interest margin (5)	4.22%	4.04%	3.96%
Interest rate margin on average total assets (6)	4.01%	3.83%	3.79%
Average interest-earning assets / average interest-bearing liabilities	110.51%	109.44%	109.62%
Non-interest expense / average total assets	2.45%	2.79%	2.88%
Efficiency ratio (7)	55.78%	64.41%	67.30%
Regulatory Capital Ratios (8)			
Tangible capital	8.57%	8.24%	8.03%
Core capital	8.57%	8.24%	8.03%
Tier one risk based capital	11.63%	11.38%	11.03%
Total risk based capital	12.88%	12.64%	12.28%
Asset Quality Ratios			
Non-performing loans / gross loans receivable (9)	0.50%	0.48%	1.19%
Non-performing assets / total assets (10)	0.57%	0.42%	0.98%
Net charge-offs / average gross loans receivable	0.00%	0.02%	0.08%
Allowance for loan losses / gross loans receivable (9)	1.54%	1.41%	1.35%
Allowance for loan losses / non-performing loans	308.82%	295.96%	113.14%
Allowance for total estimated losses / non-performing assets	233.94%	295.96%	113.14%
Other Data			
Number of full-service customer facilities	8	8	8
Number of limited service customer facilities	1	--	--
Number of stand alone loan production offices	1	--	--
Number of ATM's	11	11	11

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(1) Regulatory Capital Ratios and Asset Quality Ratios are end of period ratios. With the exception of end of period ratios, all ratios are based on average daily balances during the indicated periods.
(2) Return on average assets is net income divided by average total assets.
(3) Return on average stockholders' equity is net income divided by average stockholders' equity.
(4) Interest rate spread during the period represents the difference between the weighted average yield on interest-earning assets and the weighted average cost of interest-bearing liabilities.
(5) Net interest margin equals net interest income as a percent of average interest-earning assets.
(6) Interest rate margin on average total assets equals net interest income as a percent of average total assets.
(7) The efficiency ratio is calculated by dividing non-interest expense by the sum of net interest income and non-interest income. The efficiency ratio measures how much in expense the Company invests in order to generate each dollar of net revenue.
(8) Regulatory capital ratios are defined in Item 1. - "Business - Supervision And Regulation - Regulatory Capital Requirements And Capital Categories."
(9) Gross loans receivable includes loans held for investment and loans held for sale, less undisbursed loan funds and unamortized yield adjustments.

(10) Non-performing assets includes all nonperforming loans (nonaccrual loans and restructured loans) and real estate acquired via foreclosure or by acceptance of a deed in lieu of foreclosure.

Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations.

The following discussion and analysis should be read in conjunction with the Company's Consolidated Financial Statements and Notes to the Consolidated Financial Statements presented elsewhere in this Annual Report. Certain matters discussed or incorporated by reference in this Annual Report including, but not limited to, matters described in this Item 7., are forward looking statements that are subject to risks and uncertainties that could cause actual results to differ materially from those projected or implied in such statements.

General

The Company's primary business is providing financial services to individuals, families, community organizations, non-profit organizations, and businesses. The Company is headquartered in Watsonville, California, along the Central Coast. The Bank's history dates to 1925.

The Company pursues its business through conveniently located branch offices, where it attracts checking, money market, savings, and certificate of deposit accounts. These deposits, and other available funds, are invested in a variety of loans and securities. The vast majority of the Company's loans at December 31, 2002 were secured by various types of real estate. The Bank's deposit gathering and lending markets are concentrated in the communities surrounding its eight full service branch offices located in Santa Cruz, northern Monterey, and southern Santa Clara Counties, in California. However, during 2002, the Company took a number of steps to geographically diversify its lending throughout more of the State of California. The Company also conducts its business by a variety of electronic means, including Internet banking, telephone banking, and ATM networks.

The most significant component of the Company's revenue is net interest income. Net interest income is the difference between interest and dividend income, primarily from loans, mortgage backed securities, and investment securities, and interest expense, primarily on deposits and borrowings. The Company's net interest income and net interest margin, which is defined as net interest income as a percent of average interest-earning assets, are affected by its asset growth and quality, its asset and liability composition, and the general interest rate environment.

The Company's service charges on deposits, mortgage loan servicing fees, mortgage banking income, and commissions from the sale of non-FDIC insured insurance products and investments through Portola also have significant effects on the Company's results of operations. An additional major factor in determining the Company's results of operations are non-interest expenses, which consist primarily of employee compensation, occupancy and equipment expenses, data and item processing fees, and other operating expenses. The Company's results of operations are also significantly affected by the level of provisions for loan losses and general economic and competitive conditions, particularly absolute and relative levels and changes in market interest rates, government

policies, and actions of regulatory agencies.

As discussed under "Item 1. Business - Company Strategy", the Company is in the process of transforming itself from a savings and loan association that was historically focused upon funding residential mortgage loans with certificates of deposit into a community based commercial bank offering a far wider scope of financial services to individuals, families, professionals, organizations, and businesses. This transformation is being undertaken to enhance stockholder value while at the same time better meeting the financial needs of current and prospective customers. This transformation presents significant execution risk, as the strategic profile being pursued by the Company requires much greater human and technological resources to accomplish than the Company's historical operations. In addition, community commercial banking is by nature a higher risk activity than traditional savings & loan business, with increased credit and operational risks, among other risk factors.

Critical Accounting Policies And Significant Estimates

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Notes to the Consolidated Financial Statements contain a summary of the Company's significant accounting policies, including a presentation of recently issued accounting pronouncements. The Company follows accounting policies typical to the community commercial banking industry and in compliance with various regulations and guidelines as established by the Financial Accounting Standards Board ("FASB") and the Company's primary federal regulator, the OTS.

Certain of the accounting policies as well as estimates made by Management are considered to be important to the portrayal of the Company's financial condition, since they require Management to make difficult, complex, or subjective judgments and estimates, some of which may relate to matters that are inherently uncertain. Management has discussed each of these significant accounting policies and the related estimates with the Audit Committee of the Board of Directors.

The Company's most significant management accounting estimate is the appropriate level for the allowance for loan losses. The Company follows a methodology for calculating the appropriate level for the allowance for loan losses. However, various factors, many of which are beyond the control of the Company, could lead to significant revisions in the amount of allowance for loan losses in future periods, with a corresponding impact upon the results of operations. In addition, the calculation of the allowance for loan losses is by nature inexact, as the allowance represents Management's best estimate of the loan losses inherent in the Company's credit portfolios at the reporting date. These loan losses will occur in the future, and as such cannot be determined with absolute certainty at the reporting date. See also "Asset Quality / Credit Profile - Allowance For Loan Losses".

Other estimates that the Company utilizes in its accounting include the valuation of financial instruments and the expected useful lives of depreciable assets, such as buildings, building improvements, equipment, and furniture. The useful lives of various technology related hardware and software can be subject to change due to advances in technology and the general adoption of new standards for technology or interfaces among computer or telecommunication systems.

The Company applies Accounting Principles Board ("APB") Opinion No. 25 and related interpretations in accounting for stock options. Under APB No. 25, compensation cost for stock options is measured as the excess, if any, of the fair market value of the Company's stock at the date of grant over the amount the employee or director must pay to acquire the stock. Because the Company's stock option Plans provide for the issuance of options at a price of no less than the fair market value at the date of grant, no compensation cost is required to be recognized for the Plans.

Had compensation costs for the stock option Plans been determined based upon the fair value at the date of grant consistent with SFAS No. 123, "Accounting For Stock Based Compensation", the Company's net income and earnings per share would have been reduced. The amount of the reduction for the fiscal years 2000 through 2002 is disclosed in Note 1 to the Consolidated Financial Statements, based upon the assumptions listed therein.

GAAP itself may change over time, impacting the reporting of the Company's financial activity. Although the economic substance of the Company's transactions would not change, alterations in GAAP could affect the timing or manner of accounting or reporting.

Certain Activities Not Conducted By The Company

At December 31, 2002, the Company did not have:

- foreign currency risk, as all of the Company's operations are conducted in US dollars
- interest rate swap, cap, floor, or collar agreements; or other freestanding or embedded derivatives
- off balance sheet activity other than normal commitments to fund loans and lines of credit and honor commercial letters of credit
- special purpose entities
- debt securities convertible into equity

In conjunction with its interest rate risk management program, the Company may, however, in the future enter into interest rate swap, cap, floor, collar, or similar arrangements. In addition, the Company may pursue different types and sources of capital in the future to support its growth, including trust preferred securities or convertible securities.

Primary Risks Experienced By The Company

The greatest single source of risk to the Company is credit risk. Credit risk is the financial exposure to borrowers' not repaying the loans extended by the Company. Other significant risks experienced by the Company are interest rate risk and operational risk. Interest rate risk is the financial exposure resulting from changes in nominal and relative interest rates, as more fully discussed under "Item 7a. Quantitative and Qualitative Disclosure of Market Risk". Operational risk results from the Company's funds transfer and related activities, whereby the Company could experience loss if funds were inappropriately transferred and not recovered. The Company maintains extensive policies and procedures and certain insurance policies designed to mitigate

these primary risks. However, no set of practices can eliminate every potential current and future source of these risks. In addition, the Company creates economic value and earns income in part through the effective management, but not elimination, of these primary risks.

Interest Rate Environment

In January 2001, the Federal Reserve commenced what would become a historically large and rapid decrease in interest rates, as the economy slowed and eventually fell into recession. During 2001, the Federal Reserve cut interest rates a total of 11 times for an aggregate decrease of 475 basis points.

Most interest rate indices rose during the first quarter of 2002, as the capital markets were optimistic about a relatively rapid and strong rebound in US economic activity, fueled in part by the accommodative monetary policy implemented by the Federal Reserve in 2001. For example, during 2001, homeowners refinanced a significant volume of residential mortgages, lowering their monthly payments and / or obtaining "cash out" amounts. This supported consumer discretionary spending.

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However, by the second quarter of 2002, it became evident that the pace of US economic growth would be restrained by multiple factors including:

- weak business spending and capital investment
- waves of layoffs by major corporations, which in turn contributed to relatively high levels of continued unemployment in 2002
- limited stimulus from the weak economies of major trading partners, particularly Japan and Germany

As a result, most interest rates decreased during the second quarter of 2002. Declining equity markets in the third quarter of 2002 encouraged a flow of funds into the fixed income markets, which in turn contributed to a further reduction in most interest rates between June and September 2002. At its November 2002 meeting, the Federal Open Market Committee of the Federal Reserve voted to cut its target federal funds rate by a generally unexpectedly large 50 basis points to 1.25%. Interest rates at the end of 2002 were thus the lowest in decades.

Two other factors significantly influenced the capital markets, and hence the level of interest rates, in 2002:

1. The crisis in corporate confidence arising from the Enron, WorldCom, and similar corporate scandals contributed uncertainty to the equity markets in 2002, making it more challenging for the stock market to mount a sustained recovery that might contribute to rising interest rates.
2. Geopolitical concerns contributed to a flight of capital to quality and liquidity, which in turn led to lower rates for Treasury securities and a buildup of balances in relatively safe and liquid investments such as money market mutual funds and federally insured bank deposits.

The Treasury yield curve was inverted at the beginning of 2001. Inverted yield curves often present challenges to financial institutions, as

short term funding rates can be higher than longer term investment rates. By mid 2001, the Treasury yield curve had returned to its more traditional positive slope. By the end of 2001, the Treasury yield was the steepest in the past two years, with a 333 basis point differential between the three month and ten year Treasury instruments. Steep, positively sloped yield curves are generally favorable for financial institutions, including the Company, as near term cash flows from intermediate to longer term higher yielding assets can be funded at comparatively low interest rates.

The Treasury yield curve flattened in 2002, as longer term interest rates declined more rapidly than short term interest rates. At the end of 2002, the differential between the three month Treasury bill and the 10 year Treasury note had declined to 262 basis points. This yield curve flattening contributed to a mortgage refinance boom of historic proportions in 2002, as borrowers sought to lock in the lowest long term, fixed interest rates in decades. The Mortgage Banker's Association Refinance Index rose from just over 1,000 at the end of the first quarter of 2002 to over 6,000 during the fourth quarter of 2002. A value of 1,000 for this Index is generally considered an active refinance market. The refinance boom led to a surge in prepayment speeds on mortgage loans and mortgage related securities during the fourth quarter of 2002.

The past two years thus represented a period of substantial interest rate volatility, with significant changes in the nominal and relative levels of interest rates. This magnitude of interest rate volatility presents additional challenges to financial institutions, including the Company, in managing cash flows and interest rate risk exposure.

The table below presents an overview of the interest rate environment during the two years ended December 31, 2002. The 11th District Cost Of Funds Index ("COFI") and the 12 MTA Index ("12 MTA" - the 12 month cumulative average of the 1 year Treasury Constant Maturities Index or "1 Year CMT") are by nature lagging indices that trail changes in more responsive interest rate indices such as those associated with the spot Treasury or LIBOR markets.

Index/ Rate (1)	12/31/00	3/31/01	6/30/01	9/30/01	12/31/01	3/31/02	6/30/02
3 month Treasury bill	5.89%	4.28%	3.65%	2.37%	1.72%	1.78%	1.68%
6 month Treasury bill	5.70%	4.13%	3.64%	2.35%	1.79%	2.10%	1.74%
2 year Treasury note	5.09%	4.18%	4.24%	2.85%	3.02%	3.72%	2.81%
5 year Treasury note	4.97%	4.56%	4.95%	3.80%	4.30%	4.84%	4.03%
10 year Treasury note	5.11%	4.92%	5.41%	4.59%	5.05%	5.40%	4.80%
Target federal funds	6.50%	5.00%	3.75%	3.00%	1.75%	1.75%	1.75%
Prime rate	9.50%	8.00%	6.75%	6.00%	4.75%	4.75%	4.75%
3 month LIBOR	6.40%	4.88%	3.84%	2.59%	1.88%	2.03%	1.86%
12 month LIBOR	6.00%	4.67%	4.18%	2.64%	2.44%	3.00%	2.29%
1 Year CMT (2)	5.60%	4.30%	3.58%	2.82%	2.22%	2.57%	2.20%
12 MTA (2)	6.11%	5.71%	5.10%	4.40%	3.48%	2.91%	2.55%
COFI (2)	5.62%	5.20%	4.50%	3.97%	3.07%	2.65%	2.85%

(1) Indices / rates are spot values unless otherwise noted.
(2) These indices / rates are monthly averages.

Business Strategy

The Company's overall business objective is to maximize stockholder value. The Company's directors and Management believe that the best approach to achieving that key objective is to continue the Company's strategic transformation from a traditional savings & loan into a community commercial bank offering a broader range of financial services, products, and solutions to individuals, families, professionals, organizations, and businesses in California. The Company's directors and Management also believe that following a relationship focused approach to helping customers attain their financial goals progresses the Company toward its key strategic objective while also improving the quality of life in the communities served by the Company and making the Company a desirable employer. The Company's business strategy thus integrates advancing the interests of its three key constituencies: stockholders, local communities, and employees.

Specific elements of the Company's business strategy include:

- Increasing the ratio of loans to assets as a means of enhancing net interest income, serving more customers, moderating exposure to changes in interest rates, and better utilizing the Company's capital resources.

- Diversifying the product mix within the loan portfolio to reduce the concentration in residential mortgages while also meeting the financing needs of consumers and businesses within the Company's market areas.

- Enhancing the delivery of relationship banking, where the Company's employees invest time and resources in thoroughly understanding their customers and thereby provide a comprehensive financial services solution.

- Expanding services for businesses, including improved deposit courier service and cash management products.

- Acquiring customers disaffected by the acquisition of their financial services provider or branch office.

- Capitalizing on the Company's position as one of the largest independent financial institutions in the Greater Monterey Bay Area and on the Bank's 77 year history.

- Bolstering non-interest income as a percent of total revenues, with such non-interest income sourced from an expanding list of fee based products and services, including ATM surcharges, deposit account and branch service charges, and sales of non-FDIC insured investment products including mutual funds and annuities.

- Changing the Company's deposit mix to emphasize transaction accounts as a means of cementing customer relationships, lowering the Company's relative cost of funds, generating fee income, and increasing the duration of the Company's funding.

- Capitalizing on business opportunities unique to the Company's primary service areas; for example, installing remote ATM's at highly trafficked tourist attractions.

- Pursuing alternative forms of delivery and new technologies for financial

products and services as a means of attracting a greater volume of business while also improving the Company's efficiency ratio.

- Adding additional branch or loan production office facilities to better and more completely serve the Company's key market areas.

- Increasing the Company's visibility in and contributions to its local communities through the donation of equipment, funds, and employee time to a wide range of organizations committed to improving the quality of life in the Greater Monterey Bay Area.

The Company intends to continue pursuing this business strategy in 2003, with specific goals of adding a de novo full service branch in its primary market area, pursuing opportunities for the acquisition of existing bank branches, expanding the Commercial Banking group, increasing customer use of Internet banking and electronic bill payment, recruiting additional experienced commercial bankers, pursuing additional remote ATM sites, implementing new technologies complementary to the core data processing system installed in 2001, and effectively managing the Company's strong capital position. However, there can be no assurance that any such steps will be implemented, or if implemented, whether such steps will improve the Company's financial performance.

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Analysis Of Results Of Operations For The Years Ended December 31, 2002 And December 31, 2001

Overview

For the year ended December 31, 2002, net income was a record $5.64 million, equivalent to $1.67 basic earnings per share and $1.61 diluted earnings per share. This compares to net income of $3.75 million, or $1.15 basic earnings per share and $1.12 diluted earnings per share, for the year 2001. The $1.89 million (50.3%) increase in net income for the year 2002 compared to 2001 primarily resulted from two key factors:

- the continued implementation of the Company's strategic plan to transform the Bank into a community commercial bank with a focus on relationship banking and strong commitment to community involvement

- during the year 2001, the Company incurred pre-tax operating costs of $447 thousand for the conversion of the core data processing system and $284 thousand for legal and other expenses associated with the arbitration of claims by a former executive

Return on average stockholders' equity improved from 7.94% in 2001 to 10.50% in 2002, and was 11.64% for the fourth quarter of 2002. Return on average assets rose from 0.73% in 2001 to 1.00% in 2002. At December 31, 2002, the Company had record levels of loans, assets, and stockholders' equity. Tangible book value per share increased from $14.08 at December 31, 2001 to $16.00 at December 31, 2002. The closing price of the Company's common stock increased from $15.50 per share on December 31, 2001 to $19.95 per share on December 31, 2002.

The Company's financial performance increased sequentially from the first quarter of 2002 through to the fourth quarter, which represented the highest quarterly earnings in the Company's history. The fourth quarter of 2002 financial results generated the seventh consecutive quarter of increased diluted earnings per share.

Net Interest Income

Net interest income increased from $19.7 million in 2001 to $22.6 million in 2002 due to both expanded spreads and growth in the average balances of interest earning assets and liabilities. The Company's ratio of net interest income to average total assets increased from 3.83% in 2001 to 4.01% in 2002 despite the Company's difficulty in decreasing NOW and Savings deposit rates at the same pace as the declines in indices used for adjustable rate loans. The Company's NOW and Savings deposit rates were already at low nominal levels before the significant interest rate cuts (totaling 525 basis points) implemented by the Federal Reserve in 2001 and 2002. The Company moderated the impact of these factors in 2002 through its proactive asset / liability management program and a shift in balance sheet composition.

The expansion in the Company's net interest margin on average interest earning assets has constituted a key component in the Company's improved financial performance over the past several years. The trend for this ratio has been:

Year	Net Interest Margin
1999	3.69%
2000	3.96%
2001	4.04%
2002	4.22%

The above trend has resulted from the actions taken by the Company coincident with its strategic business plan.

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The $2.8 million, or 14.4%, increase in net interest income generated in 2002 versus 2001 primarily resulted from five factors:

1. Change In Asset Mix

Average net loans receivable increased from 83.8% of average total assets in 2001 to 85.9% of average total assets in 2002. Lower yielding cash equivalents, investment securities, and mortgage backed securities all declined as a percentage of average total assets in 2002 versus 2001. The benefits from this shift in asset mix were significant, as the average rate earned on net loans receivable in 2002 was 7.01%, substantially above the 1.72% earned on cash equivalents, 2.87% earned on investment securities, and 3.01% earned on mortgage backed securities.

2. Change In Loan Mix

Residential loans decreased from 42.2% of gross loans held for investment at December 31, 2001 to 33.1% at December 31, 2002. This reduced concentration was offset by nominal and relative increases in comparatively higher yielding commercial real estate, construction, land, and commercial business loans.

3. Change in Liability Mix

Average transaction deposit accounts (DDA, NOW, Savings, and Money Market combined) as a percentage of average total deposits rose from 41.1% in 2001 to 44.5% in 2002. Transaction deposit accounts present a lower cost of funding than most alternative sources. Non-interest bearing demand deposit accounts ("DDA") rose from 4.6% of average total deposits in 2001 to 5.1% in 2002. The Company has targeted increased DDA balances, particularly from business customers, as an important component of its business strategy.

4. Increased Average Balance Sheet

Average total assets increased by 9.1% from 2001 to 2002. The larger average balances of interest earning assets and interest bearing liabilities, combined with expanding spreads, contributed toward greater nominal net interest income.

5. Increased Capital Generation

The increasing profitability of the Company in 2002 combined with capital management activities, including the use of stock based compensation in lieu of certain cash compensation, to increase the ratio of average stockholders' equity to average total assets from 9.16% in 2001 to 9.55% in 2002. The greater relative level of interest free funding associated with the Company's capital position contributed to the expansion in the ratio of net interest income to average total assets and the growth in net interest income.

Net interest income was also benefited in 2002 versus 2001 by a rise in the ratio of average interest earning assets to average interest bearing liabilities from 109.44% to 110.51%, which occurred despite:

1. the Company's purchase of $9.0 million in Bank owned life insurance in December 2002 (a non-interest earning asset)

2. a continued rise in net deferred tax assets during 2002 arising primarily from:

   A. the Company's increase in its allowance for loan losses

   B. the differential between book and tax amortization periods for core deposit intangibles

The Company plans to expand net interest income in future periods through the further implementation of its business strategy, increasing the volume of interest earning assets and more effectively leveraging the Company's capital position, and continuing to proactively manage the Company's exposure to changes in the nominal and relative levels of general market interest rates. However, no assurance can be provided that the Company will be successful in this regard, particularly if further interest rate cuts are implemented by the Federal Reserve. Such additional interest rate cuts, depending upon market conditions, could cause margin compression for the Company, as there is little opportunity for the Company to further reduce its NOW and Savings deposit account rates, which averaged 0.34% and 0.52%, respectively, in 2002. In addition, the economic value of the Company's demand deposit balances could further erode in a declining interest rate environment, as those interest free funds would perhaps be invested at lower yields.

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Average Balances, Average Rates, And Net Interest Margin

The following table presents the average amounts outstanding for the

major categories of the Company's assets and liabilities, the average rate earned upon each major category of interest earning assets, the average rate paid for each major category of interest bearing liabilities, and the resulting net interest spread, net interest margin, and average interest margin on total assets for the years indicated.

	Year Ended December 31, 2002			Year Ended December 31, 2001			Ye
	Average Balance	Interest	Avg. Rate	Average Balance	Interest	Avg. Rate	
Assets				(Dollars In Thousands)			
Interest earning assets:							
Cash equivalents (1)	$ 3,257	$ 56	1.72%	$ 7,598	$ 314	4.13%	$
Investment securities	7,347	211	2.87%	7,318	406	5.55%	
Mortgage backed securities (2)	37,676	1,133	3.01%	38,795	2,360	6.08%	
Loans receivable, net (3)	483,429	33,890	7.01%	432,020	35,485	8.21%	
FHLB stock	3,277	196	5.98%	3,065	166	5.42%	
Total interest earning assets	534,986	35,486	6.63%	488,796	38,731	7.92%	
Non-interest earnings assets	27,514			26,555			
Total assets	$562,500			$515,351			$
Liabilities & Equity							
Interest bearing liabilities:							
NOW accounts	$ 43,607	149	0.34%	$ 40,944	366	0.89%	$
Savings accounts	18,732	98	0.52%	19,370	216	1.12%	
Money market accounts	114,629	2,419	2.11%	92,237	3,452	3.74%	
Certificates of deposit	249,088	7,787	3.13%	246,315	12,415	5.04%	
Total interest-bearing deposits	426,056	10,453	2.45%	398,866	16,449	4.12%	
FHLB advances	57,355	2,436	4.25%	47,526	2,518	5.30%	
Other borrowings (4)	705	18	2.55%	244	23	9.43%	
Total interest-bearing liabilities	484,116	12,907	2.67%	446,636	18,990	4.25%	
Demand deposit accounts	22,856			19,104			
Other non-interest bearing liabilities	1,835			2,396			
Total liabilities	508,807			468,136			
Stockholders' equity	53,693			47,215			
Total liabilities & equity	$562,500			$515,351			$
Net interest income		$22,579			$19,741		
Interest rate spread (5)			3.96%			3.67%	

Net interest earning assets	50,870		42,160	
Net interest margin (6)		4.22%		4.04%
Net interest income / average total assets		4.01%		3.83%
Interest earnings assets / interest bearing liabilities	1.11		1.09	

Average balances in the above table were calculated using average daily figures. Interest income is reflected on an actual basis, as the Company maintained no tax preferenced securities during the periods reported.

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(1) Includes federal funds sold, money market fund investments, banker's acceptances, commercial paper, interest earning deposit accounts, and securities purchased under agreements to resell.
(2) Includes mortgage backed pass-through securities and CMOs.
(3) In computing the average balance of loans receivable, non-accrual loans and loans held for sale have been included. Amount is net of deferred loan fees, premiums and discounts, undisbursed loan funds, and allowances for loan losses. Interest income on loans includes amortized loan fees and costs, net, of $353,000, $223,000, and $250,000 in 2002, 2001, and 2000, respectively.
(4) Includes federal funds purchased, securities sold under agreements to repurchase, and borrowings under MBBC's line of credit.
(5) Interest rate spread represents the difference between the average rate on interest earning assets and the average rate on interest bearing liabilities.
(6) Net interest margin equals net interest income before provision for loan losses divided by average interest earning assets.

Rate / Volume Analysis

The most significant impact on the Company's net interest income between periods is derived from the interaction of changes in the volumes of and rates earned or paid on interest-earning assets and interest-bearing liabilities. The following table utilizes the figures from the preceding table to present a comparison of interest income and interest expense resulting from changes in the volumes and the rates on average interest earning assets and average interest bearing liabilities for the years indicated. Changes in interest income or interest expense attributable to volume changes are calculated by multiplying the change in volume by the prior year average interest rate. The changes in interest income or interest expense attributable to interest rate changes are calculated by multiplying the change in interest rate by the prior year average volume. The changes in interest income or interest expense attributable to the combined impact of changes in volume and changes in interest rate are calculated by multiplying the change in rate by the change in volume.

	Year Ended December 31, 2002 Compared To Year Ended December 31, 2001	Year Ended Decem Compared Year Ended Decem
	Increase (Decrease) Due To	Increase (Decre

	Volume	Rate	Volume / Rate	Net	Volume	Rate
				(Dollars In Thousands)		
Interest-earning assets						
Cash equivalents	$ (179)	$ (183)	$ 104	$ (258)	$ (59)	$ (187)
Investment securities	2	(196)	(1)	(195)	(123)	(194)
Mortgage backed securities	(68)	(1,193)	34	(1,227)	(1,048)	(481)
Loans receivable, net	4,223	(5,199)	(619)	(1,595)	4,474	(1,358)
FHLB Stock	11	17	2	30	4	(54)
Total interest-earning assets	3,989	(6,754)	(480)	(3,245)	3,248	(2,274)
Interest-bearing liabilities						
NOW Accounts	24	(226)	(15)	$ (217)	70	(225)
Savings accounts	(7)	(115)	4	(118)	63	(105)
Money market accounts	838	(1,506)	(365)	(1,033)	207	(757)
Certificates of deposit	140	(4,715)	(53)	(4,628)	871	(762)
Total interest-bearing deposits	995	(6,562)	(429)	(5,996)	1,211	(1,849)
FHLB advances	521	(499)	(104)	(82)	205	(186)
Other borrowings	43	(17)	(31)	(5)	(10)	2
Total interest-bearing liabilities	1,559	(7,078)	(564)	(6,083)	1,406	(2,033)
Increase (decrease) in net interest income	$ 2,430	$ 324	$ 84	$ 2,838	$ 1,842	$ (241)

Interest Income

Interest income for the year ended December 31, 2002 totaled $35.5 million, a decrease of $3.2 million from $38.7 million in the prior year. This 8.4% decrease was caused by the impacts of the lower interest rate environment more than offsetting the effects of greater average balances of interest earning assets and a shift in the earning asset mix.

Interest income on loans decreased 4.5% from $35.5 million in 2001 to $33.9 million in 2002, as the effect of a decline in average rate from 8.21% in 2001 to 7.01% in 2002 more than offset the impact of greater average balances. Because the vast majority of the Company's loans are either adjustable rate or fixed rate for a limited period of time and then adjustable rate, the declining interest rate environment prevalent throughout 2001 and 2002 reduced the Company's yield on its loan portfolio. Historically high prepayments also contributed toward lower loan yields in 2002, as higher yielding loans paid off and were replaced with relatively lower yielding new originations. The drop in loan yield during 2002 was, however, moderated by periodic caps and lifetime floors on certain loan products.

Interest income on mortgage backed securities declined from $2.4 million in 2001 to $1.1 million in 2002 due to both lower average balances and significantly reduced average rates. The reduction in average balances was intentional, as the Company used scheduled principal payments, principal prepayments, and sales of mortgage backed securities to support the expansion in the loan portfolio and achieve the targeted shift in asset mix. The decline in average rates was caused by:

- the general decline in interest rates, as adjustable rate mortgage backed securities repriced downwards and as new security purchases during 2002 generally had lower effective rates than the securities in the portfolio at the end of 2001

- a shift in the mix of mortgage backed securities away from long term, fixed rate pass=though certificates and moderate duration CMO's to low duration CMO's and seasoned balloon mortgage backed securities in conjunction with the Company's asset / liability management program

- accelerated purchase premium amortization for mortgage backed securities, particularly CMO's acquired in mid 2002 that then prepaid at historically high speeds during the third and fourth quarters of 2002

- a shift in the mix of collateralized mortgage obligations away from comparatively higher yielding Non Agency issued securities toward Agency issued securities in order to obtain greater liquidity and to increase the amount of securities eligible for use as collateral for various types of deposits

Please refer to Note 4 to the Consolidated Financial Statements for additional information regarding mortgage backed securities.

Interest income on investment securities decreased from $406 thousand in 2001 to $211 thousand in 2002 due to a decline in average yield from 5.55% to 2.87%. The Company owned the same two investment securities during 2001 and 2002. These bonds are variable rate corporate trust preferred securities that adjust quarterly based upon the 3 Month LIBOR Index. The yield on these securities paralleled the decline in the three month LIBOR Index during 2001 and 2002, as presented in a previous table. Please refer to Note 3 to the Consolidated Financial Statements for additional information regarding investment securities.

Interest income on cash equivalents declined from $314 thousand in 2001 to $56 thousand in 2002 due to both lower average balances and lower average rates. An objective of the Company is to minimize its cash & cash equivalent position, subject to ensuring the maintenance of sufficient liquidity, in order to allocate investable funds toward higher yielding types of assets. Because cash equivalents are of limited term, they repriced downward quickly in 2001 and 2002.

Dividend income on FHLB stock increased from $166 thousand in 2001 to $196 thousand in 2002 due to a larger average balance and higher yields. The Company purchased additional shares of FHLB stock in 2002 in conjunction with an expansion in its use of FHLB advances. The FHLB=SF paid a relatively high dividend rate in 2002 when compared to most capital market benchmarks. The Company's yield on FHLB stock during 2002 was also bolstered by the declaration of a particularly high dividend rate for the fourth quarter of 2001, which was paid in the first quarter of 2002 and exceeded the Company's estimated accrual

rate.

Interest Expense

Interest expense for the year ended December 31, 2002 totaled $12.9 million, representing a decrease of $6.1 million, or 32.0%, from $19.0 million in the prior year. This decrease resulted from the change in the mix of interest bearing liabilities and the effect of lower average rates more than offsetting the impact of greater average balances of interest bearing liabilities.

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Interest expense on interest bearing deposits decreased from $16.4 million in 2001 to $10.5 million in 2002, as the change in composition and the effect of lower effective rates more than offset the impact of greater average balances. The increased average balances were in conformity with the Company's strategic plan of increasing market share in its local communities and better meeting the savings, funds management, and investment needs of individuals and businesses in the Greater Monterey Bay Area. The lower average rates in 2002 versus 2001 resulted from the lower interest rate environment and a shift in deposit mix away from relatively higher cost certificates of deposit toward relatively lower cost transaction accounts. Certificates of deposit constituted 55.5% of average total deposits in 2002, compared to 58.9% the prior year. The weighted average cost of interest bearing deposits declined from 4.12% in 2001 to 2.45% in 2002. An increase in attractively priced deposits in conjunction with the State of California Time Deposit program also contributed to the decrease in average deposit costs in 2002.

Interest expense on FHLB advances and other borrowings decreased by $87 thousand from 2001 to 2002, as the impact of an increase in average balances was more than offset by the effect of a reduction in average rate. While the Company has access to various types of borrowings, most borrowings in 2002 were concentrated in FHLB advances. The various credit programs from the FHLB=SF provide the Company with the opportunity to undertake specific borrowings designed to meet current and projected funding needs while also facilitating the asset / liability management program. The average effective rate on borrowings other than FHLB advances was inflated in 2002 and 2001 by the amortization of the commitment fee associated with MBBC's line of credit from a correspondent bank, combined with a lack of outstanding balances on the line.

Provision For Loan Losses

Implicit in lending activities is the risk that losses will occur and that the amount of such losses will vary over time. Consequently, the Company maintains an allowance for loan losses by charging a provision to operations. Loans determined to be losses are charged against the allowance for loan losses. The allowance for loan losses is maintained at a level considered by Management, at a point in time and with then available information, to be adequate to provide for estimable and probable losses inherent in the existing portfolio.

In evaluating the adequacy of the allowance for loan losses, Management estimates the amount of probable loss for each individual loan that has been identified as having greater than standard credit risk, including loans identified as criticized ("Special Mention"), classified ("Substandard" or lower graded), impaired, troubled debt restructured, and non=performing. In determining specific and formula loss estimates, Management incorporates such factors as collateral value, portfolio composition and concentration, trends in

local and national economic and real estate conditions, the duration of the current business cycle, seasoning of the loan portfolio, historical credit experience, and the financial status of borrowers. While the overall allowance is segmented by broad portfolio categories to analyze its adequacy, the allowance is general in nature and is available for the loan portfolio in its entirety. Although Management believes that the allowance is adequate, future provisions are subject to continuing evaluation of inherent risk in the loan portfolio, as conducted by both Management and the Bank's regulators.

Provisions for loan losses increased from $1.4 million in 2001 to $1.5 million in 2002. The amount of provision expense in 2002 resulted from the Company's determination of its level of allowance for loan losses. Factors that contributed to the Company's increasing its allowance for loan losses in 2002 included:

- the growth in the loan portfolio

- the change in loan portfolio mix toward credit categories that the Company believes present higher inherent risks, and therefore should be accompanied by suitably higher reserve levels

- the establishment of a $462 thousand specific reserve for a commercial real estate loan

Factors that moderated the required level of allowance for loan losses and hence provision levels for 2002 included:

- the Company's favorable credit experience in 2002, with net charge=offs of just $13 thousand

- reductions in balances of criticized and classified loans

For additional information regarding the allowance for loan losses, provision expense, and the Company's credit profile and experience, please see "Item 1. Business = Credit Quality".

To the extent that the Company is successful in its business strategy and thereby continues building the size of its loan portfolio while also extending increased volumes of construction, income property, and commercial business lending, Management anticipates that additional provisions will be required and charged against operations in 2003, with the ratio of allowance for loan losses to loans receivable increasing to reflect the greater credit exposure inherent in the loan mix.

Non-Interest Income

Non-interest income decreased from $2.6 million in 2001 to $2.1 million in 2002. This decline resulted from lower levels of non=interest income from all of the Company's primary sources of non=interest income with the exception of gain on the sale of loans, which benefited from the increase in residential mortgage refinancing that occurred in 2002. Reversing this decline in non=interest income and building a recurring and expanded stream of fee=based revenues are key business objectives for the Company in 2003.

Customer service charge income decreased from $1.7 million in 2001 to $1.5 million in 2002. In conjunction with the conversion to the new core data

processing system in March 2001, the Company implemented a restructured consumer checking product line and an associated revised fee and service charge schedule. These changes contributed to the closing of certain lower balance, recurring overdraft, and / or higher transaction volume consumer checking accounts beginning in the second quarter of 2001, as such accounts began incurring increased service charges. The closure of these accounts contributed to the reduced levels of customer service charge income for the full year, but also decreased certain operating costs for the Company.

Gains on the sale of loans totaled $170 thousand during 2002, a 93.2% increase from the $88 thousand recorded during 2001. Mortgage banking income during 2002 benefited from the historically low interest rate environment and record national refinance volume. At the beginning of 2003, the Company commenced offering a greater variety of residential mortgages under an expanded relationship with a secondary market conduit. This expansion was pursued in light of the Company's desire to continue reducing the percentage of total loans held for investment comprised of residential mortgages while at the same time continuing to meet the home financing needs of its local communities.

Commissions from the sale of non=FDIC insured investment products were $125 thousand during 2002, compared to $244 thousand during 2001. This decrease was primarily due to vacancies in positions for licensed investment sales representatives and the general state of the capital markets during 2002.

Loan servicing income totaled $63 thousand during 2002, down from $101 thousand during 2001. The Company continues to sell the vast majority of its long term, fixed rate residential loan production into the secondary market on a servicing released basis, and purchases more interest rate sensitive loans as part of its interest rate risk management program. Additions to loans serviced for others during 2002 were thus limited to loan participations sold to correspondent banks. As a result, the portfolio of loans serviced for others continues to decline as loans pay off. At December 31, 2002, the Company serviced $35.3 million in various types of loans for other investors, compared to $42.6 million at December 31, 2001. The Company maintained loan servicing assets of $35 thousand at December 31, 2002, and is thus limited in its exposure of loan servicing income to the accelerated loan prepayment speeds now occurring as a result of the low interest rate environment and high volume of residential mortgage refinance activity.

Gains on sale of mortgage backed securities during 2002 totaled $35 thousand, down from $190 thousand during 2001. The Company's security sales during 2002 were limited to the sale of two collateralized mortgage obligations. These securities were sold in conjunction with the Company's interest rate risk management program. Although the market value of many of the Company's mortgage backed securities exceeded historic carrying cost during 2002 due to the decline in most capital markets interest rates, the Company retained the securities as a means of generating net interest income.

Further augmenting non=interest income, both nominally and a percentage of total revenue, constitutes a primary component of the Company's business strategy. In 2003, the Company plans to enhance its fee income by continuing to market electronic bill payment and debit card services, increasing the number of transaction deposit accounts, conducting more trade finance business, and selling depository and cash management services to business customers who would be charged via account analysis.

Non-Interest Expense

Non-interest expense decreased from $14.4 million in 2001 to $13.8 million in 2002. Factors contributing to lower expenses in 2002 included the 2001 nonrecurring expenses associated with its data processing conversion ($447 thousand) and the arbitration of claims by a former executive ($284 thousand). Costs for the 2001 data processing conversion included de-conversion fees, printing and postage costs for additional customer communications, employee training and travel costs, and consulting fees for technology professionals.

Compensation and employee benefits costs increased from $6.9 million in 2001 to $7.6 million in 2002 due to:

- compensation costs associated with the Los Angeles loan production office which opened during the first quarter of 2002
- other staff additions and changes in support of the Company's strategic plan, particularly in the Company's commercial banking, income property lending, and information technology functions
- higher costs for the Bank's Employee Stock Ownership Plan due to the greater average market price of the Company's common stock
- higher costs for payroll taxes on a greater compensation base
- increased expenses for worker's compensation insurance, which is a general problem faced by businesses in the State of California

In 2003, the Company plans to further modify its various performance based incentive plans to better integrate employee compensation with measurement criteria directly related to financial contribution, economic value created, customer retention, and new customer development. Management believes that closely linking employee compensation with performance and contributions in support of the strategic plan is a key component of successfully and timely achieving the objectives of the strategic business plan.

Data and item processing costs decreased from $876 thousand in 2001 to $567 thousand in 2002 due to:

- the Company's operating on its new in-house core processing platform for all of 2002, versus only about 9 months in 2001
- the Company's multiple steps to improve the efficiency by which it operates, such as conducting expanded marketing of combined statements (multiple accounts on one statement) and imaged checking statements (check images returned instead of the physical checks) in 2002

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Legal and accounting expenses decreased from $863 thousand in 2001 to $442 thousand in 2002. This reduction was primarily due to the aforementioned arbitration in 2001, and due to the Company's utilizing more cost effective providers for certain professional services in 2002. In addition, the Company during 2002 commenced performing certain regulatory filing functions internally at lower cost.

Advertising and promotion costs totaled $300 thousand during 2002, up from $251 thousand during 2001. These costs were unusually low in the first half

of 2001, as the Company postponed certain advertising and promotional activities due to the implementation of the new computer systems environment. Advertising expenses during 2002 were concentrated in print advertising for consumer deposits and radio advertising targeted at local businesses.

Deposit insurance premiums decreased from $198 thousand for 2001 to $140 thousand for 2002, despite the expansion in the Company's deposit portfolio. The decline resulted from an adjustment in the Company's insurance premium rate effective July 1, 2002. The lower insurance premium rate will also favorably impact deposit insurance expenses during the first half of 2003.

Consulting expenses declined from $333 thousand in 2001 to $97 thousand in 2002. The Company incurred significant professional costs during 2001 in support of a data processing systems conversion to an in-house, client / server, relational database environment from a prior service bureau system.

Other non-interest expense decreased from $2.0 million in 2001 to $1.5 million in 2002. The Company implemented a number of expense control and efficiency initiatives over the past year that moderated various operating costs. These initiatives included more cost effective check printing, supplies ordering, cellular telecommunications, and processing of certain electronic funds transfers. In addition, the Company incurred lower expenses related to the Board of Directors in 2002 versus 2001.

The Company's efficiency ratio improved from 64.41% during 2001 to 55.78% during 2002, with the ratio for the fourth quarter of 2002 favorably falling to 53.41%. While the Company continues to pursue a range of alternatives to improve its efficiency and augment revenue, further progress in this ratio will likely be tempered in coming quarters by the need to invest in support of the continued implementation of the strategic plan. These investments are projected to include product development, new branch sites, additional relationship officers, and enhanced technology-facilitated services.

Stock Based Compensation

In 2002 and 2001, the Company extensively utilized stock based compensation for directors, officers, and certain non-officer employees. The Company believes that the use of stock based compensation aligns director, officer, and employee interests with those of stockholders. The Company's stock based compensation programs are discussed in Note 18 to the Consolidated Financial Statements. Several of the Company's stock based compensation programs provide for vesting periods of up to five years, thereby also encouraging Management and employees to work in the best long term interests of the Company and its stockholders. Director retainer fees during 2001 and 2002 were paid in Company common stock. In addition, a number of the Bank's officers voluntarily accepted Company common stock in lieu of certain cash compensation during 2001 and 2002. These decisions included the election by the Chief Executive Officer and Chief Financial Officer to each receive a significant component of his 2002 incentive compensation in Company common stock.

The Company intends to continue extensively utilizing stock based compensation and incentives in 2002, including the issuance of additional stock options, as approved by stockholders, at 110% of the fair market value of the stock on the date of grant. This compares to the 100% ratio generally prevalent among similar financial institution holding companies.

Provision For Income Taxes

The provision for income taxes increased from $2.8 million in 2001 to $3.8 million in 2002 due to a rise in pre-tax income. The Company's effective book tax rate decreased from 42.6% in 2001 to 40.1% in 2002 due to:

- the Company's increased utilization of tax benefits under the State of California Enterprise Zone Program

- the purchase of Bank owned life insurance during the fourth quarter of 2002

- certain non-deductible expenses and other adjustments to taxable income representing a smaller percentage of the increased amount of book pre-tax income

- a non-recurring reduction in the Company's provision for income taxes during the third quarter of 2002 resulting from a change in California tax law

The Company's Administrative Headquarters building and Watsonville branch are located within a State of California Enterprise Zone, and the Bank has increased its lending to local businesses also domiciled within Enterprise Zones throughout California. The dividends the Company earns on the Bank owned life insurance are not subject to regular Federal and State income tax.

Comparison Of Financial Condition At December 31, 2002 And December 31, 2001

Total assets increased from $537.4 million at December 31, 2001 to a record $609.7 million at December 31, 2002.

Cash and cash equivalents decreased from $13.1 million at December 31, 2001 to $11.4 million at December 31, 2002 due to the use of cash equivalents to fund expansions in the security and loan portfolios, and to purchase Bank owned (universal) life insurance.

Investment securities at December 31, 2001 and 2002 were composed of the same two variable rate corporate trust preferred securities issued by major US banks that reprice quarterly based upon a margin over the 3 month LIBOR rate. These two securities were rated "A" and "A-" by Standard & Poors rating agency at December 31, 2002. Management may consider selling these two securities in 2003 to bolster the Bank's QTL ratio, shift funds into assets that function as more effective collateral under secured borrowing arrangements, and provide funds for further expansion in loans receivable. Increasing the QTL ratio would provide additional time before the Bank would be forced by regulation to allocate the management time and incur the operating expense associated with a change in charter from a federal thrift to either a California State or national commercial bank. Throughout 2002, the Company did not own any corporate bonds issued by companies primarily in the telecommunications, technology, or energy industries. For additional information regarding investment securities, please refer to Note 3 to the Consolidated Financial Statements.

Mortgage backed securities increased from $30.6 million at December 31, 2001 to $37.5 million at December 31, 2002. Increased collateral requirements for certain deposits contributed to the increase. All of the Company's mortgage backed securities at December 31, 2002 were rated "AAA" by at least one nationally recognized ratings agency.

During 2002, the Company continued altering the mix of its mortgage backed securities in conjunction with its asset / liability and liquidity management programs. Long term, fixed rate pass-through securities were decreased, while balloon mortgage backed securities were increased. CMO's were

shifted to higher cash flow, shorter term securities with less extension risk. These instruments provide more periodic funds that can be used to support further expansion in net loans receivable. In 2001 and 2002, Management reallocated some of the Company's capacity for longer term, fixed rate assets from the security portfolio to the loan portfolio, where better yields were available for comparable levels of interest rate risk.

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The Company also shifted the mix in CMO issuers in 2002 toward Agency issuance and away from private label, "AAA" rated securities. This alteration in mix was conducted to provide additional eligible collateral for various types of deposits, including time deposits placed by the State of California.

In 2003, the Company plans to continue emphasizing the use of balloon mortgage back securities and CMO's in its security portfolio, as the Company can use certain CMO's (e.g. Planned Amortization Classes, or "PAC's") to target future cash flows in conjunction with its asset / liability, liquidity, and balance sheet management programs.

Loans held for sale, carried at the lower of cost or market, totaled $1.5 million at December 31, 2002, compared to $713 thousand at December 31, 2001. The Company sells most of its long term, fixed rate residential mortgage production into the secondary market on a servicing released basis, and purchases more interest rate sensitive loans as part of its interest rate risk management program.

Loans held for investment, net, increased from $465.9 million at December 31, 2001 to a record $521.9 million at December 31, 2002. The increase resulted from a combination of strong internal loan originations, including activity from the Los Angeles loan production office, and from purchases of, or participations in, individual income property and construction loans from correspondent banks. In addition, during the fourth quarter of 2002, the Company purchased a $16.9 million pool of high credit quality, seasoned hybrid residential mortgages secured by first deeds of trust on California homes in order to better utilize the Company's capital, support the Bank's Qualified Thrift Lender ("QTL") ratio, and offset historically high loan payoff volumes stemming from the low interest rate environment.

Total net loans as a percentage of total assets were 85.9% at December 31, 2002, down slightly from 86.8% at December 31, 2001. The Company has targeted increasing this ratio to 90.0% as part of its strategy of supporting its interest margin, fostering economic activity in its local communities, and effectively utilizing the Bank's capital. The decline in this ratio during the fourth quarter of 2002 primarily resulted from the Company's acquisition of $9.0 million in Bank owned life insurance, as subsequently discussed. The Company plans to continue expanding its portfolio of loans held for investment in 2003, with a continuing reduction in the percentage of the portfolio comprised of residential mortgages in favor of other generally higher yielding and more interest rate sensitive types of loans.

The Company's investment in the capital stock of the Federal Home Loan Bank ("FHLB") increased from $3.0 million at December 31, 2001 to $4.7 million at December 31, 2002. This increase was due to a combination of required stock purchases stemming from the Bank's increased utilization of FHLB advances and the receipt of FHLB stock dividends.

The Company's balance of premises and equipment, net, decreased by $457 thousand in 2002, as equipment purchases were limited during 2002 following a

major investment in technology during 2001 in conjunction with the core systems conversion. Premises and equipment balances may increase more substantially in 2003 if the Company is successful in acquiring or opening de novo one or more new branch locations. For additional information regarding premises and equipment, please refer to Note 8 to the Consolidated Financial Statements.

The Company continued to amortize its core deposit intangibles during 2002, reducing their balance from $1.5 million at December 31, 2001 to $833 thousand at December 31, 2002. This amortization, which is a non-cash charge to operations, bolsters the Bank's regulatory capital ratios (all else held constant), as intangible assets are deducted from GAAP capital in determining regulatory capital. This amortization also increases the Company's tangible book value per share. For additional information regarding core deposit intangibles, please refer to Note 9 to the Consolidated Financial Statements.

At December 31, 2002, the Company maintained $35 thousand in originated mortgage servicing rights, down from $75 thousand a year earlier. Because the Company has adopted a program of generally selling its loans on a servicing released basis, Management anticipates that the balance of originated mortgage servicing rights will continue to decline as the existing portfolio of loans serviced for others pays off.

The Bank purchased $9.0 million in Bank owned life insurance during the fourth quarter of 2002. The associated policies are single premium, universal life, modified endowment contracts spread among five insurance companies with favorable credit profiles and histories of competitive policy dividend yields. The insurance was purchased to fund:

- non-qualified supplemental executive retirement benefits for the Chief Executive Officer and Chief Financial Officer that were implemented by the Company in early 2003

- the increasing expense of the tax qualified Employee Stock Ownership Plan, with associated costs rising due to the higher market price of the Company's common stock

In addition, the Bank owned life insurance policies provide significant key man insurance to the Company.

Deposits increased from $432.3 million at December 31, 2001 to $458.3 million at December 31, 2002. This increase was primarily due to:

- The Bank's issuance of its first brokered certificate of deposit ("CD"), for $20.0 million, during the second quarter of 2002. The brokered CD was issued in order to provide funding for loan production in 2002.

- A $9.0 million increase in deposits from the State of California time deposit program during 2002. The State places funds with California banks as a vehicle for encouraging employment and economic growth.

Deposit growth during 2002 was constrained by the Company's declining to match significantly above market rates offered on selected transaction accounts by two large thrifts. The Company was, however, successful in increasing the number of deposit accounts maintained by customers with commercial banking and real estate lending relationships during 2002.

The Company continues to pursue increases in transaction account

balances as a fundamental component of its strategic plan. Excluding the impact of the aggregate $29.0 million increase in brokered and State certificates of deposit during 2002, transaction accounts increased from 43.6% of total deposits at December 31, 2001 to 49.3% of total deposits at December 31, 2002. This shift in mix contributed to the Company's reducing its weighted average cost of deposits from 2.87% at December 31, 2001 to 1.94% at December 31, 2002. This 93 basis point reduction in deposit cost was attained despite the historically low level of interest rates and therefore the Company's limited ability to decrease interest rates on many deposit products that were priced between zero and one percent at December 31, 2001.

Management is, however, not satisfied with the volume of deposit acquisition achieved by its eight full service retail branches in 2002, particularly in light of general deposit inflows into the banking system from investors leaving the equity markets. Management responded to this performance by introducing new money market products, altering branch staff compensation, and hiring a new Director of Retail Banking effective in February 2003. The new Director of Retail Banking has extensive local financial industry experience and a successful track record of attracting high caliber commercial bankers and building quality customer relationships.

The prior Director of Retail Banking will continue to assist the Company in its implementation of the strategic plan by serving as Chief Administrative Officer.

Checking account balances increased from $63.6 million at December 31, 2001 to $67.2 million at December 31, 2002. The Company plans to introduce several new consumer checking products during 2003, with a particular focus on relationship pricing and providing increased choice and options to customers. In addition, the Company's commercial lending officers have increasing business demand deposit balances as a key component of their sales objectives.

During the latter part of 2002, the Company introduced "remote deposit" services to its business and high net worth individual accounts. Via this new service, the Bank's customers can make deposits to their Monterey Bay Bank checking account at any branch of a correspondent bank with over 4,900 banking locations in 23 states. Remote deposit services were implemented to offer improved convenience and assist the Bank in competing with larger financial institutions with more extensive branch networks.

Money market deposits increased from $105.8 million at December 31, 2001 to $126.1 million at December 31, 2002. Factors supporting the rise in money market balances in 2002 included the Company's active cross-selling of this product in its branches and the desire by certain customers to avoid committing funds to term certificates of deposit in the current historically low interest rate environment. The Company introduced two new money market accounts at the beginning of 2003: Investors Money Market and Business Money Market. Investors Money Market is a highly tiered product targeted to attract funds from money market mutual funds and brokerage firms. Business Money Market is a product designed specifically for the Bank's local commercial customers seeking an attractive return on liquid funds while also enjoying the many attractive attributes provided by the Bank, including Internet banking, global ATM access, 24 hour bilingual telephone banking, and superior customer service provided by local bankers familiar with their business. For additional information regarding deposits, please refer to Note 10 to the Consolidated Financial Statements.

In early 2003, the Bank was actively negotiating for the lease of a

3,000 square foot building to serve as a de novo branch in its primary market area. In addition, effective in January 2003, the Bank received approval from the Office of Thrift Supervision to operate a branch at the Company's existing Administrative Headquarters building in Watsonville. This branch will primarily serve the Bank's growing base of commercial business, construction, and income property real estate customers who are served by relationship officers operating from the Headquarters building.

Borrowings increased from $53.8 million at December 31, 2001 to $93.8 million at December 31, 2002. The increase was associated with funding the rise in the loan and security portfolios. All of the Company's FHLB advances at December 31, 2002 were fixed rate, fixed term or overnight borrowings without call or put option features.

Consolidated stockholders' equity increased from $50.2 million at December 31, 2001 to a record $56.1 million at December 31, 2002 due to a combination of:

- net income
- continued amortization of deferred stock compensation
- additional paid-in capital generated from the Employee Stock Ownership Plan and the Performance Equity Plan
- Directors continuing to receive their retainer fees in Company common stock
- the exercise of 48,463 vested stock options

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The above factors more than offset the impact of the depreciation in the aggregate fair value of securities classified as available for sale and acquisitions of common stock under the Company's repurchase program. The depreciation in the portfolio of securities classified as available for sale was concentrated in reduced market prices for the Company's two corporate trust preferred securities. The Company's stock repurchases during 2002 were comprised of the following:

2002 Quarter	Number Of Shares Repurchased	Price Of Shares Repurchased
First	5,000	$16.25
Second	None	--
Third	5,000	$17.10
	5,000	$17.20
	5,000	$17.24
	5,000	$17.25
	5,000	$17.36
Fourth	31,000	$18.15
Full Year 2002	61,000	$17.62 average

At December 31, 2002, there were 53,035 remaining shares authorized for repurchase under the Company's current repurchase program.

The Company did not declare or pay any cash dividends in 2002. In 2000, the Company announced the indefinite suspension of the declaration and payment of cash dividends. The Board of Directors continues to believe that, at this time, the Company's capital is better utilized in growing the balance sheet, expanding the Bank's franchise value, and repurchasing shares versus paying a cash dividend. In addition, paying a nominal cash dividend would cause the Company to incur additional operating costs for processing, mailing, and tax information reporting.

While the Company has no current plans to commence paying cash dividends in 2003, the Company would reconsider this position should a significant revision to the Internal Revenue Code occur in regards to the tax treatment of dividends, as has recently been proposed by the Administration in Washington. However, no assurance can be provided regarding future changes to the Internal Revenue Code, if any, and what the Company's response to such changes might be, if any.

The Company's tangible book value per share increased from $14.08 at December 31, 2001 to $16.00 at December 31, 2002. The Company's tangible book value per share benefits from the amortization of deferred stock compensation and core deposit intangibles, in addition to periodic earnings and other factors that add to stockholders' equity without increasing the number of shares outstanding.

Analysis Of Results Of Operations For The Years Ended December 31, 2001 And December 31, 2000

Overview

For the year ended December 31, 2001, net income was $3.75 million, equivalent to $1.15 basic earnings per share and $1.12 diluted earnings per share. This compares to net income of $2.52 million, or $0.81 basic and diluted earnings per share, for the year 2000. Return on average stockholders' equity increased from 6.24% in 2000 to 7.94% in 2001. Return on average assets increased from 0.53% in 2000 to 0.73% in 2001.

The continued implementation of the Company's strategic plan was a primary factor in the Company's improved financial performance in 2001 versus 2000. Other factors included a more favorable credit experience in 2001 versus 2000, and better results on the sale of securities.

Net Interest Income

Net interest income increased from $18.0 million in 2000 to $19.7 million in 2001 due to both expanded spreads and greater average balances of interest earnings assets. The Company's ratio of net interest income to average total assets increased from 3.79% in 2000 to 3.83% in 2001 despite the Company's difficulty in decreasing NOW and Savings deposit rates at the same pace as the declines in indices used for adjustable rate loans. The Company's NOW and Savings deposit rates were already at low nominal levels before the significant interest rate cuts (totaling 475 basis points) implemented by the Federal Reserve throughout 2001. The Company moderated the impact of these factors in 2001 through its proactive asset / liability management program and a shift in balance sheet composition.

The $1.7 million, or 9.8%, increase in net interest income generated in 2001 versus 2000 primarily resulted from four factors:

1. Change In Asset Mix

Average net loans receivable increased from 80.0% of average total assets in 2000 to 83.8% of average total assets in 2001. Lower yielding cash equivalents, investment securities, and mortgage backed securities all declined as a percentage of average total assets in 2001 versus 2000. The benefits from this shift in asset mix were significant, as the average rate earned on net loans receivable in 2001 was 8.21%, substantially above the 4.13% earned on cash equivalents, 5.55% earned on investment securities, and 6.08% earned on mortgage backed securities.

2. Change in Liability Mix

Average transaction deposit accounts (DDA, NOW, Savings, and Money Market combined) as a percentage of average total deposits rose from 40.5% in 2000 to 41.1% in 2001. Transaction deposit accounts present a lower cost of funding than most alternative sources. Non-interest bearing demand deposit accounts ("DDA") rose from 4.3% of average total deposits in 2000 to 4.6% in 2001.

3. Increased Average Balance Sheet

Average total assets increased by 8.6% from 2000 to 2001. The larger average balances of interest earning assets and interest bearing liabilities, combined with expanding spreads, contributed toward greater nominal net interest income.

4. Asset / Liability Management

Net interest income in 2001 benefited from positions taken by the Company as a result of its asset / liability management program. Early in 2001, the Company moderately increased the net liability sensitivity of the balance sheet in order to benefit from the rapid and significant interest rate cuts being implemented by the Federal Reserve. This was accomplished, in part, by adding intermediate term, fixed rate assets during the first half of the year, primarily in the form of residential hybrid mortgages.

Net interest income was also benefited in 2001 versus 2000 by an increase in average stockholders' equity, which was substantially offset by an increase in average non-interest earning assets, primarily deferred tax assets.

Interest Income

Interest income for the year ended December 31, 2001 totaled $38.7 million, an increase of $0.9 million from $37.8 million in the prior year. This 2.6% increase resulted from the effects of greater average balances of interest earning assets and a shift in the earning asset mix more than offsetting the impact of a lower interest rate environment in 2001 versus 2000.

Interest income on loans increased 9.0% from $32.6 million in 2000 to $35.5 million in 2001, as the effect of greater average balances more than offset a decline in average rate from 8.57% in 2000 to 8.21% in 2001. Because the vast majority of the Company's loans are either adjustable rate or fixed rate for a limited period of time and then adjustable rate, the declining interest rate environment prevalent throughout 2001 reduced the Company's yield on its loan portfolio. The drop in this yield was, however, moderated by

periodic caps and lifetime floors on certain loan products.

Interest income on mortgage backed securities declined from $3.8 million in 2000 to $2.4 million in 2001 due to both lower average balances and reduced average rates. The reduction in average balances was intentional, as the Company used scheduled principal payments, principal prepayments, and sales of mortgage backed securities to support the expansion in the loan portfolio and achieve the targeted shift in asset mix. The decline in average rates was caused by:

- a shift in the mix of mortgage backed securities away from long term, fixed rate pass-though certificates to lower duration collateralized mortgage obligations and adjustable rate pass through certificates in conjunction with the Company's asset / liability management program

- a shift in the mix of collateralized mortgage obligations away from Non Agency issued securities toward Agency issued securities in order to obtain greater liquidity and to increase the amount of securities eligible for use a collateral for various types of deposits

- the general decline in interest rates, as adjustable rate mortgage backed securities repriced downwards and as new security purchases during 2001 generally had lower effective rates than the securities in the portfolio at the end of 2000

Interest income on investment securities decreased from $689 thousand in 2000 to $406 thousand in 2001. This decline was due to lower average balances and lower average rates. Because all of the Company's investment securities in 2000 and 2001 were variable rate corporate trust preferred securities that adjust quarterly based upon the 3 Month LIBOR Index, these securities repriced downwards rapidly in 2001 in conjunction with the interest rate cuts implemented by the Federal Reserve.

Interest income on cash equivalents declined from $540 thousand in 2000 to $314 thousand in 2001 due to both lower average balances and lower average rates. Because cash equivalents are of limited term, they repriced downward quickly in 2001 in conjunction with the interest rate cuts implemented by the Federal Reserve..

Dividend income on FHLB stock decreased from $217 thousand in 2000 to $166 thousand in 2001 due to lower effective rates. The lower effective rates were due to the lower interest rate environment in 2001 versus 2000 and due to the FHLB-SF's decision to pay particularly high dividend rates during the first half of 2000 in conjunction with its capital management program.

Interest Expense

Interest expense for the year ended December 31, 2001 totaled $19.0 million, representing a decrease of $0.8 million, or 4.0%, from $19.8 million in the prior year. This decrease resulted from the change in the mix of interest bearing liabilities and the effect of lower average rates more than offsetting the impact of greater average balances of interest bearing liabilities.

Interest expense on interest bearing deposits decreased from $17.2 million in 2000 to $16.4 million in 2001, as the change in composition and the effect of lower effective rates more than offset the impact of greater average

balances. The lower average rates in 2001 versus 2000 resulted from the lower interest rate environment and a shift in deposit mix away from relatively higher cost certificates of deposit toward relatively lower cost transaction accounts. Certificates of deposit constituted 58.9% of average total deposits in 2001, compared to 59.5% the prior year. The weighted average cost of interest bearing deposits declined from 4.66% in 2000 to 4.12% in 2001. A rise in attractively priced funds in conjunction with the State of California Time Deposit program also contributed to the decrease in average deposit costs in 2001.

Interest expense on borrowings was nearly constant in 2000 and 2001, as the effect of an increase in average balances was offset by the impact of lower average rates. While the Company has access to various types of borrowings, most borrowings in 2001 were concentrated in FHLB advances. The average effective rate on borrowings other than FHLB advances was inflated in 2000 and 2001 by the amortization of the commitment fee associated with MBBC's line of credit from a correspondent bank.

Provision For Loan Losses

Provisions for loan losses declined from $2.2 million in 2000 to $1.4 million in 2001. The change in provisions was due to the result of the Company's methodology for calculating the level of allowance for loan losses. Factors that contributed to the reduction in provisions in 2001 versus the prior year included:

- a lower level of net charge-offs in 2001 versus 2000
- a decrease in the amount of classified loans at December 31, 2001 versus the prior year end
- a reduced concentration of relatively higher risk construction and land loans in 2001 versus 2000
- the reduction in specific reserves of $600 thousand associated with a commercial real estate construction loan that was collected in full during the second quarter of 2001
- an increased concentration of relatively lower risk residential and multifamily mortgages in 2001 versus 2000

The above factors more than offset the impact of a larger loan portfolio, including growth in commercial business loans outstanding. The above factors also more than offset higher reserve factors for the Company's portfolios of hotel / motel real estate loans and Business Express loans.

Non-Interest Income

Non-interest income totaled $2.6 million in 2001, comparing favorably to $2.3 million in 2000. The Company recorded $190 thousand in pre-tax gains on security sales in 2001, versus a pre-tax loss of $55 thousand during 2000. As discussed below, customer service charges and mortgage banking income also increased in 2001 versus the prior year, offset by reduced loan servicing income and decreased commissions from sales of non-FDIC insured investments.

Service charge income rose from $1.3 million during 2000 to $1.7 million during 2001. This increase primarily resulted from the revised fee and service charge schedule implemented with the new core processing system in 2001.

Loan servicing income totaled $101 thousand during 2001, compared to $118 thousand during 2000. The Company continues to sell the vast majority of its long term, fixed rate residential loan production into the secondary market on a servicing released basis. As a result, the portfolio of loans serviced for others is declining as loans pay off. At December 31, 2001, the Company serviced $42.6 million in various types of loans for other investors, compared to $62.0 million at December 31, 2000.

Commissions from sale of non-FDIC insured investments totaled $244 thousand during 2001, compared to $676 thousand during 2000. Less favorable general capital market conditions, the events of September 11, 2001, and investment staff turnover and vacancies contributed to the lower revenues in 2001 versus 2000.

Gains on the sale of loans increased from $23 thousand during 2000 to $88 thousand during 2001. The lower general interest rate environment in 2001 led to a strong residential loan refinance market, which in turn bolstered the Company's mortgage banking activity.

Non-Interest Expense

Non-interest expense rose $0.7 million, or 5.1%, from $13.7 million in 2000 to $14.4 million in 2001. Total non-interest expense in 2001 was increased by costs for the March 2001 data processing conversion ($447 thousand) and legal and other expenses associated with the arbitration of claims by a former executive ($284 thousand). Total non-interest expenses in 2000 included $108 thousand in costs for the data processing conversion and $250 thousand accrued for settlement of the claims by the former executive. Costs for the data processing conversion included de-conversion fees to the prior service bureau, printing and postage costs for additional customer communications, employee training and travel costs, and consulting fees for technology professionals retained to assist with and speed the implementation of the new system.

Throughout 2001, the Company adjusted its staffing to advance the strategic plan, primarily through the hiring of commercial loan officers and professional bankers. Staffing was also increased in the data processing function, coincident with the Company's shifting from an external service bureau to in-house data processing. The change in the Company's systems environment also impacted various other operating expenses. Data processing fees were much lower in 2001 versus 2000, while equipment expense was higher due to the added depreciation from the new hardware and software installed in 2001.

Compensation and employee benefit costs also increased in 2001 versus 2000 for payments under certain incentive compensation plans. These expenses rose in 2001 in conjunction with the Company's improved financial performance. Costs for the Bank's employee stock ownership plan ("ESOP") increased in 2001 versus 2000 because of the higher average price of Monterey Bay Bancorp, Inc. common stock.

Advertising and promotion costs during 2001 were $249 thousand, down from $361 thousand in 2000 primarily due to the Company's reducing certain marketing efforts early in 2001 while the core processing conversion was being completed.

The Company's efficiency ratio improved from 67.30% in 2000 to 64.41% in 2001. This ratio has been unfavorably impacted during the past two years by the up front operating costs and other expenses that the Company has incurred in advance of associated revenues as the Company has implemented its strategic

plan. The Company has made investments in new staff and new systems that are necessary to successfully market a broader range of financial products to a greater segment of individuals and businesses in its primary market areas. These investments by nature had to precede the associated revenues.

Provision For Income Taxes

The provision for income taxes increased from $1.9 million in 2000 to $2.8 million in 2001 due to a rise in pre-tax income. The Company's effective book tax rate decreased slightly in 2001 versus the prior year.

Comparison Of Financial Condition At December 31, 2001 And December 31, 2000

Total assets of the Company were $537.4 million at December 31, 2001, compared to $486.2 million at December 31, 2000, an increase of $51.2 million, or 10.5%.

Cash & cash equivalents decreased from $25.2 million at December 31, 2000 to $13.1 million at December 31, 2001 due to the Company's using cash equivalents to fund an expansion in the loan portfolio.

Investment securities at December 31, 2000 and 2001 were composed of the same two variable rate corporate trust preferred securities issued by major US banks that reprice quarterly based upon a margin over the 3 month LIBOR rate.

Mortgage backed securities decreased from $43.0 million at December 31, 2000 to $30.6 million at December 31, 2001. During 2001, the Company utilized cash flows from sales and principal payments on mortgage related securities to fund an increase in the loan portfolio.

Loans held for sale, carried at the lower of cost or market, totaled $713 thousand at December 31, 2001. The Company sells most of its long term, fixed rate residential mortgage production into the secondary market on a servicing released basis, and purchases more interest rate sensitive loans as part of its interest rate risk management program.

Loans held for investment, net, increased from $391.8 million at December 31, 2000 to a record $465.9 million at December 31, 2001. The increase resulted from a combination of strong internal loan originations and from pool purchases of various types of California real estate loans. Net loans as a percentage of total assets increased from 80.6% at December 31, 2000 to 86.8% at December 31, 2001, in conjunction with the Company's strategy of supporting its interest margin, fostering economic activity in its local communities, and effectively utilizing the Bank's capital.

The Company's investment in the capital stock of the FHLB increased from $2.9 million at December 31, 2000 to $3.0 million at December 31, 2001. Stock dividends and capital stock purchases during 2001 were partially offset by a mandatory capital stock redemption.

The Company's balance of premises and equipment, net, increased by $243 thousand in 2001 primarily due to hardware and software purchased in support of the new core processing system.

The Company continued to amortize its core deposit intangibles during 2001, reducing their balance from $2.2 million at December 31, 2000 to $1.5

million at December 31, 2001.

Total liabilities rose 10.1% from $442.4 million at December 31, 2000 to $487.2 million at December 31, 2001. This $44.8 million increase was approximately split between an increase in deposits and an increase in borrowings. Accounts payable and other liabilities decreased by $0.9 million during 2001 primarily due to the timing of interest payments on borrowings, a reduction in accrued liabilities for deferred compensation and non-qualified retirement plans, and the 2001 settlement of claims by a former executive which had been accrued at December 31, 2000.

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Deposits increased from $407.8 million at December 31, 2000 to a record $432.3 million at December 31, 2001. The Company experienced strong growth in money market deposits during 2001 due to a combination of sales and marketing focus and the historically low interest rate environment's leading certain customers to delay committing funds to term certificates of deposit. Deposit growth during 2001 was, however, restrained by a small number of very large competitors that conducted aggressive promotional campaigns based on paying interest rates significantly above levels offered by most money center, regional, and California community banks. Deposit growth during 2001 was also restrained by customer response to the new systems environment, as the Company eliminated passbooks in favor of statement accounts and as certain deposit products were repriced upwards to reflect competitive market conditions or the Company's costs of providing the accounts. Certificates of deposit declined from 60.0% of total deposits at December 31, 2000 to 56.4% of total deposits at December 31, 2001, despite a $5.0 million increase in funds from the State of California Time Deposit Program.

FHLB advances increased from $32.6 million at December 31, 2000 to $53.6 million at December 31, 2001. During 2001, the Company utilized FHLB advances to fund some of the expansion in the loan portfolio. During the fourth quarter of 2001, the Company prepaid $10.0 million in FHLB advances due in the first quarter of 2002 in order to extend the term structure of that debt in conjunction with the Company's asset / liability management program. Despite the Company's strong capital position in 2001, Management did not pursue extensive leveraging via wholesale assets and liabilities, such as FHLB advances. Management believes the Company's capital is better deployed in meeting the financial needs of individuals, families, and businesses, and that much lesser economic value is created by engaging in wholesale leveraging strategies.

Consolidated stockholders' equity increased from $43.8 million at December 31, 2000 to $50.2 million at December 31, 2001 due to a combination of:

- net income
- continued amortization of deferred stock compensation
- Directors receiving their fees in Company stock
- appreciation in the portfolio of securities classified as available for sale, recorded in other comprehensive income
- the exercise of vested stock options

The Company did not declare or pay any cash dividends in 2001. The Company did not conduct any share repurchases during 2001. The Company's tangible book value per share increased from $12.54 at December 31, 2000 to

$14.08 at December 31, 2001.

Off-Balance Sheet Transactions, Arrangements, And Obligations

At December 31, 2002, the Company did not have any free-standing derivatives, loans sold with recourse, retained or contingent interests in assets transferred to an unconsolidated entity, special purpose entities, or material variable interests in unconsolidated entities. None of the Company's leases contain requirements that the Company's payment obligation change based on a multiplier or similar abstract basis.

At December 31, 2002, the Company maintained various commitments to fund loans and to make funds available under lines of credit. Please refer to "Item 1. Business - Loan Commitments" and Note 15 to the Consolidated Financial Statements for additional information in this regard.

The Company had outstanding commercial letters of credit of $401 thousand at December 31, 2002.

Liquidity

Liquidity is actively managed to ensure sufficient funds are available to meet the ongoing needs of both MBBC and the Bank. Liquidity management includes projections of future sources and uses of funds to ensure the availability of sufficient liquid reserves to provide for unanticipated circumstances. The Bank's primary sources of liquidity are deposits, principal and interest payments (including prepayments) on its asset portfolios, retained earnings, FHLB advances, other borrowings, and, to a lesser extent, sales of loans originated for sale and securities classified as available for sale. The Bank's primary uses of funds include loan originations, customer drawdowns on lines of credit and undisbursed construction loan commitments, loan purchases, customer withdrawals of deposits, interest paid on liabilities, and operating expenses.

Specific steps the Bank has taken to maintain strong liquidity include:

- arranging five federal funds lines of credit with correspondent banks in an aggregate amount of $39.5 million (funds under these lines are provided on an available, as opposed to on a committed, basis)

- completing agreements to be able to issue "DTC" or publicly traded certificates of deposit through 5 investment banks

- signing PSA agreements with four counterparties to facilitate the sale of securities under agreements to repurchase

- enrolling in the specific loan pledging program with the FHLB-SF and pledging multifamily and commercial real estate loans in addition to residential mortgages to the FHLB-SF to increase the Bank's borrowing capacity

- participating in the State of California Time Deposit Program

- reducing the duration of its security portfolio during 2002 to provide greater monthly cash flows

The Bank pledges excess collateral to the FHLB in order to have ready access to additional liquidity. At December 31, 2002, the Bank maintained available borrowing capacity in excess of $137 million at the FHLB.

From time to time, depending upon its asset and liability strategy, the Bank considers converting a portion of its residential whole loans into mortgage backed securities. These conversions provide increased liquidity because the mortgage backed securities are typically more readily marketable than the underlying loans and because they can more effectively be used as collateral for borrowings. The Bank did not securitize any portion of its residential mortgages during the years 2000 - 2002.

The Company's ratio of net loans to deposits was 114.21% at December 31, 2002. In addition to the planned deposit related actions described above, the Company intends to actively manage this ratio by:

- seeking additional branch locations, either de novo or through acquisition of existing branches from other banks

- directing a higher percentage of the advertising and promotion budget to deposit generation

- pursuing opportunities to cost effectively issue a limited volume of brokered certificates of deposit during 2003

- selling a greater percentage of total residential loan production into the secondary market

At December 31, 2002, the Bank maintained $39.4 million in commitments to originate loans and lines of credit. Management anticipates that the Bank will have sufficient funds available to meet these commitments, not all of which will necessarily be drawn upon. For additional information regarding commitments and contingencies, including available customer balances under committed lines of credit, please refer to Note 15 to the Consolidated Financial Statements.

MBBC, as a company separate from the Bank, must provide for its own liquidity. Substantially all of MBBC's cash inflows are obtained from interest on its security and cash equivalent positions, repayment of the funds advanced for the ESOP, exercise of vested stock options, sales of treasury shares to the Bank for subsequent payment as director fees, and dividends declared and paid by the Bank. There are statutory and regulatory provisions that limit the ability of the Bank to pay dividends to MBBC. As of December 31, 2002, MBBC did not have any commitments for capital expenditures or to fund loans.

At December 31, 2002, MBBC maintained a revolving $3.0 million line of credit from a correspondent bank of the Bank. This line of credit is secured by 800,000 shares of MBBC's treasury stock. There were no outstanding balances on this line of credit at December 31, 2002. The line of credit agreement contains various financial performance and reporting covenants. The terms of the line of credit do not impact or restrict MBBC's ability to pay cash dividends. The line of credit expires in March 2003. Management obtained this line of credit as a source of additional liquidity for MBBC, and, through MBBC, for the Bank. The Company expects to renew this line of credit or establish a similar line of credit with another bank upon maturity.

At December 31, 2002, MBBC had cash and cash equivalents of $3.3 million. Management knows of no factors that would restrict or eliminate the

normally recurring cash inflows obtained by MBBC.

Capital Resources

The Bank's position as a "well capitalized" financial institution under the PCA regulatory framework is further enhanced by the financial resources present at the holding company. At December 31, 2002, the consolidated GAAP capital position of the Bank was $52.8 million, while the consolidated GAAP capital position of the Company was $56.1 million. Note 14 to the Consolidated Financial Statements provides additional information concerning the Bank's regulatory capital position, including amounts by which the Bank exceeds minimum and "well capitalized" thresholds for regulatory capital.

Management believes the Bank's regulatory capital position in 2003 will benefit from the earnings for the year, plus the ongoing amortization of intangible assets and deferred stock compensation.

The potential continued increase in the size of the loan portfolio, combined with the ongoing planned shift in mix toward construction, income property, and business lending, may result in the Bank's having higher levels of nominal and risk weighted assets during 2003, thereby possibly offsetting the effect of the above factors upon regulatory capital ratios.

The Company has conducted share repurchases since 1995. Through December 31, 2002, the Company had repurchased 1,330,600 shares of its common stock, including 61,000 shares in 2002. At December 31, 2002, there were 3,454,315 shares outstanding. The Company had 53,035 shares remaining for repurchase at December 31, 2002 under its current repurchase program.

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Transactions With Related And Certain Other Parties

The Company's conduct of business with directors, officers, significant stockholders, and other related parties (collectively, "Related Parties") is restricted and governed by various laws and regulations, including Regulation O as promulgated and enforced by the Federal Reserve. Furthermore, it is the Company's policy to conduct business with Related Parties only on an arms-length basis at current market prices with terms and conditions no more favorable than the Company provides in its normal course of business.

The Bank extends loans to its directors and their related interests only after approval of a majority of disinterested Directors and with the associated director abstaining from voting. The Bank also extends loans, primarily residential mortgages and home equity lines of credit, to its employees under its employee loan program. The Bank's officers are eligible to participate in the employee loan program. Note 5 to the Consolidated Financial Statements presents the Company's credit commitments to directors and executive officers.

The Company periodically utilizes the professional services of a marketing and advertising corporation with which one executive officer is affiliated. All business orders and all invoices associated with this corporation are approved by disinterested executive officers. Total payments to this marketing and advertising corporation in 2002 were $190 thousand, which included certain pass-through payments for media advertising.

The Company employs various individuals that are related to other

employees, such as spouses, siblings, children, and other relatives. It is Company policy to disallow related employees to have a direct reporting or supervisory relationship. At December 31, 2002, the spouses of two senior officers and the cousin of one senior officer were also employees of the Company.

The Company believes that the above transactions with related parties were conducted on an arms-length basis with normal terms and conditions. The Company also believes that the above transactions with related parties did not impair stockholder value or present any actual or potential conflicts of interest that were not appropriately addressed by disinterested parties.

Impact Of Inflation And Changing Prices

The Consolidated Financial Statements and Notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"), which requires the measurement of most financial positions and operating results in terms of historical dollar amounts without considering the changes in the relative purchasing power of money over time due to inflation. Unlike industrial companies, the Company's assets and liabilities are nearly all monetary in nature. Consequently, relative and absolute levels of interest rates present a greater impact on the Company's performance and condition than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services. The Company's operating costs, however, are subject to the impact of inflation, particularly in the case of salaries and benefits costs, which typically constitute about one-half of the Company's total non-interest expense.

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Item 7a. Quantitative And Qualitative Disclosure Of Market Risk.

The results of operations for financial institutions such as the Company may be materially and adversely affected by changes in prevailing economic conditions, including rapid changes in interest rates, declines in real estate market values, and the monetary and fiscal policies of the federal government. Interest rate risk ("IRR") and credit risk typically constitute the two greatest sources of financial exposure for banks and thrifts. For a discussion of the Company's credit risk, please see "Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations - Provision For Loan Losses". The Company utilizes no derivatives to mitigate either its credit risk or its IRR, instead relying on loan review and adequate loan loss reserves in the case of credit risk and portfolio management techniques in the case of IRR. The Company is not significantly exposed to foreign currency exchange rate risk, commodity price risk, or other market risks other than interest rate risk.

IRR represents the impact that changes in absolute and relative levels of general market interest rates might have upon the Company's net interest income, results of operations, and theoretical liquidation value, also called net portfolio value ("NPV"). Interest rate changes impact earnings and NPV in many ways, including effects upon the yields generated by variable rate assets, the cost of deposits and other sources of funds, the exercise of options embedded in various financial instruments (especially residential mortgages), and customer demand for and market supply of different financial assets, liabilities, and positions.

In order to manage IRR, the Company has established an Asset / Liability Management Committee ("ALCO"), which includes representatives from senior management and the Board of Directors. ALCO is responsible for managing the Company's financial assets and liabilities in a manner that balances profitability, IRR, and various other risks (e.g. liquidity). ALCO operates under policies and within risk limits prescribed by and periodically reviewed and approved by the Board of Directors.

The primary objective of the Company's IRR management program is to maximize net interest income while controlling IRR exposure to within prudent levels. Financial institutions are subject to IRR whenever assets and liabilities mature or reprice at different times (repricing, or gap, risk), based upon different capital markets indices (basis risk), for different terms (yield curve risk), or are subject to various embedded options, such as the right of mortgage borrowers to refinance their loans when general market interest rates decline. Companies with high concentrations of real estate lending, such as the Company, are significantly impacted by prepayment rates on loans, as such prepayments generally return investable funds to the Company at a time of relatively lower prevailing general market interest rates.

Decisions to control or accept IRR are analyzed with consideration of the probable occurrence of future interest rate changes. Stated another way, IRR management encompasses the evaluation of the likely additional return associated with an incremental change in the IRR profile of the Company. For example, having liabilities that mature or reprice faster than assets can be beneficial when interest rates decline, but may be detrimental when interest rates rise. Assessment of potential changes in market interest rates and the relative financial impact to earnings and NPV is used by the Company to help quantify and manage IRR. As with credit risk, the complete elimination of IRR would curtail the Company's profitability, as the Company generates a return, in part, through effective risk management.

The Company monitors its interest rate risk using various analytical methods that include participation in the OTS net portfolio value interest rate risk modeling. The Company's exposure to IRR as of December 31, 2002 was within the limits established by the Board of Directors.

A common, if analytically limited, measure of financial institution IRR is the institution's "static gap". Static gap is the difference between the amount of assets and liabilities (adjusted by off balance sheet positions, if any) that are expected to mature or reprice within a specified period. A static gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities in a given time period or cumulatively through that time period. The converse is true for a negative static gap.

The following table presents the maturity and rate sensitivity of interest-earning assets and interest-bearing liabilities as of December 31, 2002. The "repricing gap" figures in the table reflect the estimated difference between the amount of interest-earning assets and interest-bearing liabilities that are contractually scheduled to mature or reprice (whichever occurs first) during future periods.

At December 31, 2002

	3 Months Or Less	More Than 3 Months To 1 Year	More Than 1 Year To 3 Years	More Than 3 Years To 5 Years	Over 5 Years
			(Dollars In Thousands)		
Assets					
Interest-earning cash equivalents	$ 49	$ --	$ --	$ --	$ --
Investment securities	7,030	--	--	--	--
Mortgage backed securities	3,151	--	--	--	34,315
Loans held for sale	--	--	--	--	1,545
Loans receivable, net of LIP	180,349	96,749	124,856	113,008	15,408
FHLB stock	4,679	--	--	--	--
Gross interest-earning assets	195,258	96,749	124,856	113,008	51,268
Plus / (Less):					
Unamortized yield adjustments	--	--	--	--	--
Allowance for loan losses	--	--	--	--	--
Interest-earning assets	195,258	96,749	124,856	113,008	51,268
Non-interest-earning assets	--	--	--	--	--
Total assets	$ 195,258	$ 96,749	$ 124,856	$ 113,008	$ 51,268
Liabilities and Equity					
NOW accounts	$ 43,629	$ --	$ --	$ --	$ --
Savings accounts	18,474	--	--	--	--
Money market accounts	126,061	--	--	--	--
Certificates of deposit	73,698	108,626	52,514	11,783	--
Total interest-bearing deposits	261,862	108,626	52,514	11,783	--
Borrowings	34,223	40,000	13,782	4,800	1,000
Total interest bearing liabilities	296,085	148,626	66,296	16,583	1,000
Non-interest bearing liabilities	--	--	--	--	--
Stockholders' equity	--	--	--	--	--
Total liabilities and equity	$ 296,085	$ 148,626	$ 66,296	$ 16,583	$ 1,000
Periodic repricing gap	(100,827)	(51,877)	58,560	96,425	50,268
Cumulative repricing gap	(100,827)	(152,704)	(94,144)	2,281	52,549
Periodic repricing gap as a % of interest earning assets	(17.6%)	(9.1%)	10.2%	16.9%	8.8%
Cumulative repricing gap as a % of interest earning assets	(17.6%)	(26.7%)	(16.5%)	0.4%	9.2%
Cumulative net interest-earning assets as a % of cumulative interest-bearing liabilities	65.9%	65.7%	81.6%	100.4%	109.9%

As presented in the prior table, at December 31, 2002, the Company's cumulative one year and three year static gaps, based upon contractual repricing and maturities (i.e. ignoring prepayments and other non-contractual factors) were (17.6%) and (16.5%), respectively, of total interest earning assets. These figures suggest that net interest income would increase if general market interest rates were to decline (and vice-versa), reflecting a "net liability sensitive" position.

However, static gap analysis such as that presented above fails to capture material components of IRR, and therefore provides only a limited, point in time view of the Company's IRR exposure. The assumptions and factors that are by definition excluded from static gap analysis prepared on a contractual basis encompass:

- prepayments on assets
- how rate movements and the shape of the Treasury curve, or the LIBOR swap curve, affect borrower behavior
- that all loans and deposits repricing at a given time will not adjust to the same degree or by the same magnitude
- that the nature of rate changes for assets and liabilities in the over one-year category have a greater long term economic impact than those for shorter term assets and liabilities
- transaction deposit accounts (significant to the Company) do not have scheduled repricing dates or contractual maturities, and therefore may respond to interest rate changes differently than other financial instruments
- potential Company strategic and operating responses to changes in absolute and relative interest rate levels
- the financial impact of options embedded in various financial instruments

Another measure of IRR, required to be performed by insured depository institutions regulated by the OTS, is a procedure specified by Thrift Bulletin 13a, "Interest Rate Risk Management". This test measures the impact upon NPV of an immediate and sustained change in interest rates in 100 basis point increments. The following table presents the estimated impacts of such changes in interest rates upon the Company as of December 31, 2002, calculated in compliance with Thrift Bulletin 13a. However, the results from any cash flow simulation model are dependent upon a lengthy series of assumptions about current and future economic, behavioral, and financial conditions, including many factors over which the Company has no control. These assumptions include, but are not limited to, prepayment rates on various asset portfolios and decay rates on core deposits, including savings, checking, and money market accounts. Because of the uncertainty regarding the accuracy of assumptions utilized and because such an analytical technique does not contemplate any actions the Company might undertake in response to changes in interest rates, no assurance can be provided that the valuations presented in the following table are representative of what might actually be obtainable. In addition, the following figures are by definition not indicative of the Company's economic value as a going concern or of the Company's market value.

Projected Change From

(Dollars In Thousands)	NPV	Dollars
Change In Interest Rates (In Basis Points)		
+300	$ 72,763	$ (3,051
+200	$ 74,765	$ (1,049
+100	$ 75,932	$ 118
Base Scenario	$ 75,814	$ --
-100	$ 75,755	$ (59

Note:NPV results for downward rate changes of more than 100 basis points were not calculated at 12/31/02 due to the low level of interest rates.

The level of interest rate risk exposure presented in the above table is generally considered "low" in the financial services industry.

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The prior table results show that the Company's theoretical liquidation value at December 31, 2002 is not significantly impacted by immediate and sustained parallel interest rate shocks in either direction. This result differs from that suggested by the static gap analysis presented above, which indicates that the Company would benefit from a declining interest rate environment, and vice-versa. This divergence is due to the inherent limitations in the static gap approach; in particular the omission of asset prepayments and the incomplete consideration of the financial dynamics of transaction account deposits. As just one example, the Company's CMO's are presented as having a maturity of greater than five years in the static gap table, which is correct based upon their legal maturity dates. However, the actual duration (weighted average life of the associated discounted cash flows) of the Company's CMO portfolio at December 31, 2002 was estimated to be less than one year based upon current prepayment speeds and the priority of principal allocation within the tranches of the CMO's.

The reduction in net portfolio value in the plus 200 and plus 300 basis point rate shock scenarios presented in the prior table in part results from the embedded options, held by borrowers, within most mortgage related products, as described in the following paragraph.

Under rising interest rates, many of the Company's mortgage related assets experience a lengthening of duration and slower repricing, resulting in a reduction in market value. This occurs due to slower prepayment behavior by borrowers, and in conjunction with embedded options such as periodic and lifetime rate adjustment caps on adjustable rate loans. This prepayment behavior is a result of borrowers behaving in their economic self interests by more slowly (or not at all) curtailing or prepaying loans with interest rates at or below current market rates.

On the other hand, under falling interest rates, the increase in the Company's net portfolio value is constrained by a shortening of asset duration. This occurs due to the faster prepayment behavior on mortgage related assets, as borrowers take advantage of a lower interest rate environment to refinance their loans. This refinancing provides cash flow into the Company at a time when

reinvestment alternatives present lower rates than the assets being paid off. One technique the Company uses to moderate this impact is to originate certain types of loans with prepayment penalties.

The Company further moderated its interest rate risk exposure during 2002, shifting from slightly net liability sensitive at December 31, 2001 to approximately interest rate neutral at December 31, 2002. This moderation resulted from many factors, including:

- a general decrease in asset duration in conjunction with the historically low interest rate environment and the mortgage refinance boom, which in turn led to historically high prepayment speeds

- the shift in loan mix toward relatively more interest rate sensitive construction, income property, and commercial business loans and away from residential mortgages

- pricing loan products and introducing new loan products to more strongly encourage customer selection of more interest rate sensitive loans

- an increase in the Company's transaction account base and the shift in deposit mix toward transaction accounts

- the restructuring of the Company's security portfolio

- the continued sale of the vast majority of the Company's current production of long term, fixed rate residential mortgages into the secondary market

- an increase in the weighted average maturity of the Company's certificate of deposit portfolio, resulting from the Company's actively marketing intermediate to longer term certificates of deposit and from customer demand for longer term certificates of deposit in a declining interest rate environment in order to maintain a given level of monthly interest income

The continued implementation of the strategic plan also contributed to the reduction in net liability sensitivity during 2002 through the expansion of commercial banking and relationship banking for real estate professionals. Commercial banking is by nature an asset sensitive business, as loans are generally variable rate, frequently based upon the Prime Rate, while deposits often include a significant non-interest bearing demand deposit component. The Company's construction and income property relationship officers provide custom designed, but generally interest rate sensitive, loans to real estate professionals, who are then encouraged to maintain transaction accounts, including income property operating (checking) accounts, with the Company.

Despite the Company's IRR management program and the initiatives detailed above, due to the multiple factors which influence the Company's exposure to IRR, many of which are beyond the control of the Company, there can be no assurance that the Company's earnings or economic value will be maintained in future periods, nor that the Company will be successful in continuing to maintain a relatively low level of IRR exposure. These risks and exposures are particularly uncertain should the Federal Reserve again decrease its benchmark interest rates in 2003, with interest rates then possibly falling to record low levels. Behaviors by borrowers, depositors, and the capital markets in extremely low interest rate environments have not been tested in a modern economy with great ease of funds mobility and unparalleled information availability through the Internet and other technological means.

Item 8. Financial Statements And Supplementary Data.

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Independent Auditors' Report

Consolidated Statements Of Financial Condition As Of December 31, 2002 and 2001

Consolidated Statements Of Income For The Years Ended
December 31, 2002, 2001, and 2000

Consolidated Statements Of Changes In Stockholders' Equity For The Years Ended
December 31, 2002, 2001, and 2000

Consolidated Statements Of Cash Flows For The Years Ended
December 31, 2002, 2001, and 2000

Notes To Consolidated Financial Statements

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Monterey Bay Bancorp, Inc.
Watsonville, California

We have audited the accompanying consolidated statements of financial condition of Monterey Bay Bancorp, Inc. and subsidiary as of December 31, 2002 and 2001, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Monterey Bay Bancorp, Inc. and subsidiary as of December 31, 2002 and 2001, and the results of their operations and their cash flows, for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

/s/ Deloitte & Touche LLP

Deloitte & Touche LLP

San Francisco, California
January 28, 2003

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2002 AND 2001
(Dollars In Thousands, Except Per Share Amounts)

ASSETS	
Cash and cash equivalents	$ 11
Securities available for sale, at estimated fair value:	
Investment securities	7
Mortgage backed securities	37
Loans held for sale, at lower of cost or market	1
Loans receivable held for investment (net of allowances for loan losses of $8,162 at December 31, 2002 and $6,665 at December 31, 2001)	521
Investment in capital stock of the Federal Home Loan Bank, at cost	4
Accrued interest receivable	2
Premises and equipment, net	7
Core deposit intangibles, net	
Bank owned life insurance	9
Real estate acquired via foreclosure, net	
Other assets	4
TOTAL ASSETS	$609

LIABILITIES AND STOCKHOLDERS' EQUITY

LIABILITIES

Deposits	$458
Advances from the Federal Home Loan Bank and other borrowings	93
Accounts payable and other liabilities	1
Total liabilities	553
Commitments and contingencies	
STOCKHOLDERS' EQUITY	
Preferred stock, $0.01 par value, 2,000,000 authorized; none issued Common stock, $0.01 par value, 9,000,000 shares authorized; 4,492,085 issued at December 31, 2002 and December 31, 2001; 3,454,315 outstanding at December 31, 2002 and 3,456,097 outstanding at December 31, 2001	
Additional paid-in capital	29
Retained earnings, substantially restricted	42
Unallocated ESOP shares	
Treasury shares designated for compensation plans, at cost (11,769 shares at December 31, 2002 and 17,969 shares at December 31, 2001)	
Treasury stock, at cost (1,037,770 shares at December 31, 2002 and 1,035,988 shares at December 31, 2001)	(14
Accumulated other comprehensive loss, net of taxes	
Total stockholders' equity	56
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$609

See Notes to Consolidated Financial Statements

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars In Thousands, Except Per Share Amounts)

	Year Ended D	
INTEREST AND DIVIDEND INCOME:	2002	
Loans receivable	$ 33,890	$ 35
Mortgage backed securities	1,133	2
Investment securities and cash equivalents	463	
Total interest and dividend income	35,486	38

INTEREST EXPENSE:		
Deposit accounts	10,453	16
Advances from the Federal Home Loan Bank and other borrowings	2,454	2
Total interest expense	12,907	18
NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES	22,579	19
PROVISION FOR LOAN LOSSES	1,510	1
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	21,069	18
NON-INTEREST INCOME:		
Customer service charges	1,541	1
Gain on sale of loans	170	
Commissions from sales of noninsured products	125	
Income from loan servicing	63	
Gains (losses) on sale of mortgage backed securities and investment securities, net	35	
Other income	193	
Total	2,127	2
NON-INTEREST EXPENSE:		
Compensation and employee benefits	7,626	6
Occupancy and equipment	1,705	1
Amortization of intangible assets	681	
Supplies, postage, telephone, and office expenses	675	
Data and item processing	567	
Legal and accounting	442	
Advertising and promotion	300	
Deposit insurance premiums	140	
Consulting	97	
Other expenses	1,547	1
Total	13,780	14
INCOME BEFORE PROVISION FOR INCOME TAXES	9,416	6
PROVISION FOR INCOME TAXES	3,778	2
NET INCOME	$ 5,638	$ 3
EARNINGS PER SHARE:		
BASIC EARNINGS PER SHARE	$ 1.67	$
DILUTED EARNINGS PER SHARE	$ 1.61	$

See Notes to Consolidated Financial Statements

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars And Shares In Thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Treasury Shares Designated For Compensation Plans	Tre S
	Shares	Amount					
Balance At January 1, 2000	3,423	$45	$ 28,237	$ 30,473	$(1,150)	$(1,376)	$(14
Purchase of treasury stock	(120)						(1
Cash dividends paid ($0.08 per share)				(274)			
Director fees paid using treasury stock	18		9				
Amortization of stock compensation			32		230	822	
Sale of stock for stock compensation plans						216	
Comprehensive income:							
Net income				2,523			
Other comprehensive income:							
Change in net unrealized loss on securities available for sale, net of taxes of $359							
Reclassification adjustment for losses on securities available for sale included in income, net of taxes of $23							

	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Treasury Shares Designated For Compensation Plans	Tre S
Other comprehensive income, net							
Total comprehensive income							
Balance at December 31, 2000	3,321	$45	$ 28,278	$ 32,722	$ (920)	$ (338)	$(15

See Notes to Consolidated Financial Statements

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars And Shares In Thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Treasury Shares Designated For Compensation Plans	Tre S
	Shares	Amount					
Balance At December 31, 2000	3,321	$45	$ 28,278	$ 32,722	$ (920)	$ (338)	$(15
Options exercised using treasury stock	116		(5)				1
Director fees paid using treasury stock	19		47				
Amortization of stock compensation			264		230	165	
Comprehensive income:							
Net income				3,751			
Other comprehensive income:							
Change in net unrealized loss on securities available for sale, net of taxes							

of $465

Reclassification adjustment for gains on securities available for sale included in income, net of taxes of $(78)

Other comprehensive income, net

Total comprehensive income

Balance at December 31, 2001	3,456	$45	$ 28,584	$ 36,473	$ (690)	$ (173)	$(14

See Notes to Consolidated Financial Statements

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Continued)
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars And Shares In Thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Unallocated ESOP Shares	Treasury Shares Designated For Compensation Plans	Tre S
	Shares	Amount					
Balance At December 31, 2001	3,456	$45	$ 28,584	$ 36,473	$ (690)	$ (173)	$(14
Purchase of treasury stock	(61)						(1
Options exercised using treasury stock	48		159				
Director fees paid using treasury stock	11		88				
Amortization of stock compensation			450		230	60	

Comprehensive income:							
Net income				5,638			
Other comprehensive income:							
Change in net unrealized loss on securities available for sale, net of taxes of $(109)							
Reclassification adjustment for gains on securities available for sale included in income, net of taxes of $(15)							
Other comprehensive income, net							
Total comprehensive income							
Balance at December 31, 2002	3,454	$45	$ 29,281	$ 42,111	$ (460)	$ (113)	$(14

See Notes to Consolidated Financial Statements

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars In Thousands)

	Year End	
	2002	
OPERATING ACTIVITIES:		
Net income	$ 5,638	$ 3
Adjustments to reconcile net income to net cash provided by Operating activities:		
Depreciation and amortization of premises and equipment	727	

Amortization of intangible assets	681	
Amortization of purchase premiums, net of accretion of discounts	1,217	
Amortization of deferred loans fees and costs, net	(353)	
Provision for loan losses	1,510	1
Federal Home Loan Bank stock dividends	(177)	
Gross ESOP expense before dividends received on unallocated shares	638	
Compensation expense related to stock compensation plans	100	
Director retainer fees paid in stock	191	
(Gain) loss on sale of investment and mortgage-backed securities	(35)	
Gain on the sale of loans held for sale	(170)	
Loss on sale of real estate acquired via foreclosure	--	
Loss (gain) on sale of fixed assets	15	
Origination of loans held for sale	(19,206)	(12
Proceeds from sales of loans held for sale	18,544	11
Deferred income taxes	(613)	
Decrease (increase) in accrued interest receivable	48	
Appreciation on bank owned life insurance	(36)	
(Increase) decrease in other assets	(134)	(1
Increase (decrease) in accounts payable and other liabilities	364	
Other, net	(1,414)	
Net cash provided by operating activities	7,535	2
INVESTING ACTIVITIES:		
Net increase in loans held for investment	(56,042)	(74
Purchases of investment securities available for sale	(4,854)	
Proceeds from sales of investment securities available for sale	--	
Proceeds from maturities of investment securities available for sale	4,850	
Purchases of mortgage backed securities available for sale	(66,878)	(29
Principal repayments on mortgage backed securities available for sale	54,627	30
Proceeds from maturities of mortgage backed securities held to maturity	--	
Proceeds from sales of mortgage backed securities available for sale	4,500	12
(Purchases) redemptions of FHLB stock, net	(1,504)	
Purchases of Bank owned life insurance	(9,000)	
Purchases of premises and equipment	(285)	(1
Proceeds from the sale of premises and equipment	--	
Net cash used in investing activities	(74,586)	(61

See Notes to Consolidated Financial Statements

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000
(Dollars In Thousands)

	Year End	
	2002	
FINANCING ACTIVITIES:		
Net increase in deposits	25,995	24
Proceeds (repayments) of FHLB advances, net	40,000	21
Proceeds (repayments) of other borrowings, net	5	
Cash dividends paid to stockholders	--	
Purchases of treasury stock	(1,075)	
Sales of treasury stock for exercise of stock options	494	1
Sales of stock for stock compensation plans	--	
Net cash provided by financing activities	65,419	46
NET (DECREASE) INCREASE IN CASH & CASH EQUIVALENTS	(1,632)	(12
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	13,079	25
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 11,447	$ 13
SUPPLEMENTAL CASH FLOW DISCLOSURES:		
Cash paid during the period for:		
Interest on deposits and borrowings	$ 12,620	$ 19
Income taxes	$ 3,600	$ 4
SUPPLEMENTAL DISCLOSURES OF NON CASH INVESTING AND FINANCING ACTIVITIES:		
Loans transferred to held for investment, at market value	$ --	$
Real estate acquired in settlement of loans	$ 846	$

See Notes to Consolidated Financial Statements

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization And Nature Of Operations

Monterey Bay Bancorp, Inc. ("MBBC") is a unitary savings and loan holding company incorporated in 1994 under the laws of the state of Delaware. MBBC operates as the holding company for its wholly owned subsidiary Monterey Bay Bank (the "Bank"), a federally chartered savings and loan association. The Bank has one wholly owned subsidiary, Portola Investment Corporation ("Portola"), which sells various non-FDIC insured investment products and provides trustee services to the Bank. Portola operates within the Bank's facilities in segregated areas. MBBC, the Bank, and Portola are hereinafter collectively referred to as the "Company".

The Company's primary business is attracting checking, money market, savings, and certificate of deposit accounts through its branch facilities and various electronic means, and investing such deposits and other available funds in various types of loans, including real estate mortgages, business loans, construction loans, and consumer loans. The Company also provides a range of fee based services. The Bank's deposit gathering markets are primarily concentrated in the communities surrounding its full service offices located in Santa Cruz, Northern Monterey, and Southern Santa Clara Counties, in California. The Bank extends loans throughout a majority of California, with a concentration in the three counties surrounding its full service branch officers. At December 31, 2002, the Bank maintained eight full service branch offices, two administrative buildings, one stand-alone loan production office, and eleven ATM's, two of which were stand-alone.

Summary Of Significant Accounting Policies

Basis Of Consolidation - The consolidated financial statements include the accounts of Monterey Bay Bancorp, Inc. and its wholly-owned subsidiary, Monterey Bay Bank, and the Bank's wholly-owned subsidiary, Portola Investment Corporation. All significant inter-company transactions and balances are eliminated in consolidation.

Financial Statement Presentation And Use Of Estimates - The financial statements have been prepared and presented in accordance with accounting principles generally accepted in the United States of America, or "GAAP" and general practices within the banking and savings and loan industry. The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and contingent assets and liabilities, and disclosure of contingent assets and liabilities, as of the balance sheet dates and revenues and expenses for the reporting periods. Actual results could differ from those estimates.

Cash And Cash Equivalents - Cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold, investments in money market mutual funds, securities purchased under agreements to resell with original maturities of three months of less, certificates of deposit with original maturities of three months or less, and highly liquid debt instruments purchased with remaining terms to maturity of three months or less from the date of acquisition.

Securities Available For Sale - Securities to be held for indefinite periods of time, including securities that management intends to use as part of its asset / liability management strategy that may be sold in response to changes in interest rates, loan prepayments, or other factors, are classified as available for sale. Securities available for sale are carried at estimated fair value. Gains or losses on the sale of securities are determined using the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to contractual maturity. Unrealized holding gains or losses, net of tax, for securities available for sale are reported within accumulated other comprehensive income, which is a separate

component of stockholders' equity, until realized.

A decline in the fair value of individual securities available for sale below their cost that is deemed other than temporary would be recognized through a write down of the investment securities to their fair value by a charge to earnings as a realized loss.

All of the Company's securities were classified as available for sale at December 31, 2002 and 2001.

Mortgage Backed Securities - The Company's mortgage backed securities include collateralized mortgage obligations ("CMO's") issued by both Federal Agencies and private entities ("private label CMO's"). Private label CMO's expose the Company to credit and liquidity risks not typically present in Federal Agency issued securities.

Loans Held For Sale - Loans held for sale are carried at the lower of aggregate cost, including qualified loan origination costs and related fees, or estimated market value, grouped by category. Unrealized losses by category are recognized via a charge against operations. Realized gains and losses on loans held for sale are accounted for under the specific identification method. Qualified loan origination fees and costs are retained and not amortized during the period the loans are held for sale. Transfers of loans held for sale to the held for investment portfolio are recorded at the lower of cost or estimated market value on the transfer date.

Loans Receivable Held For Investment - Loans receivable held for investment are stated at unpaid principal balances less undisbursed loan funds for constructions loans, unearned discounts, deferred loan origination fees, and allowances for estimated loan losses, plus unamortized premiums (including purchase premiums) and qualified deferred loan origination costs. These loans are not adjusted to the lower of cost or market because it is management's intention, and the Company has the ability, to hold these loans to maturity.

Interest Income On Loans - Interest income on loans is accrued and credited to income as it is earned. However, interest is generally not accrued on loans over 90 days contractually delinquent. In addition, interest is not accrued on loans that are less than 90 days contractually delinquent, but where management has identified concern over future collection. Accrued interest income is reversed when a loan is placed on non-accrual status. Discounts, premiums, and net deferred loan origination fees and costs are amortized into interest income over the contractual lives of the related loans using a procedure approximating the interest method, except when a loan is in non-accrual status. When a loan pays off or is sold, any unamortized balance of any related premiums, discounts, and qualified net deferred loan origination fees and costs is recognized in income. Payments received on non-accrual loans are allocated between principal and interest based upon the terms of the underlying note.

Sales Of Loans - Gains or losses resulting from sales of loans are recorded at the time of sale and are determined by the difference between (i) the net sales proceeds plus the estimated fair value of any interests retained in the loans,

such as loan servicing rights, and (ii) the carrying value of the assets sold. The difference between the adjusted carrying value of the interests retained and the face amount of the interests retained is amortized to operations over the estimated remaining life of the associated loans using a method that approximates the interest method. The fair value of any interests retained is periodically evaluated, with any shortfall in estimated fair value versus carrying amount being charged against operations.

Troubled Debt Restructured - A loan is considered "troubled debt restructured" when the Company provides the borrower certain concessions that it would not normally consider. The concessions are provided with the objective of maximizing the recovery of the Company's investment. Troubled debt restructured includes situations in which the Company accepts a note (secured or unsecured) from a third party in payment of its receivable from the borrower, other assets in payment of the loan, an equity interest in the borrower or its assets in lieu of the Company's receivable, or a modification of the terms of the debt including, but not limited to, (i) a reduction in the stated interest rate to below market rates, (ii) an extension of maturity at an interest rate or other terms below market, (iii) a reduction in the face amount of the debt, and / or (iv) a reduction in the accrued interest receivable. The Company did not have any loans considered to be troubled debt restructurings at December 31, 2002 or December 31, 2001.

Impaired Loans - The Company considers a loan to be impaired when it is deemed probable by management that the Company will be unable to collect all contractual interest and contractual principal payments in accordance with the terms of the original loan agreement. However, when determining whether a loan is impaired, management also considers the current ratio of the loan's balance to collateral value, other sources of repayment, and the borrower's present financial position. In evaluating whether a loan is considered impaired, insignificant delays or shortfalls in payments, in the absence of other facts and circumstances, would not alone lead to the conclusion that a loan is impaired. The Company includes among impaired loans all loans that (i) are contractually delinquent 90 days or more, (ii) meet the definition of a troubled debt restructuring, (iii) are classified in part or in whole as either doubtful or loss, (iv) the Company has suspended accrual of interest, and (v) have a specific loss allowance applied to adjust the loan to fair value. The Company may also classify other loans as impaired based upon their specific circumstances.

The Company accounts for impaired loans, except those loans that are accounted for at market value or at the lower of cost or market value, at the present value of the expected future cash flows discounted at the loan's effective interest rate at the date of initial impairment, or, as a practical expedient, at the loan's observable market price or fair value of the collateral if the loan is collateral dependent. The Company evaluates the collectibility of both contractual interest and contractual principal when assessing the need for a loss accrual for impaired loans. Interest income received on impaired non-accrual loans is recognized on a cash basis. Interest income on other impaired loans is recognized on an accrual basis. The Company uses the cash basis method of accounting for payments received on impaired loans.

Real Estate Acquired Via Foreclosure - Real estate acquired via foreclosure is initially recorded at the lower of the recorded investment in the property or fair value less estimated costs to sell. If the fair value less estimated costs to sell is less than amortized cost, a charge against the allowance for loan losses is recorded at property acquisition. Following foreclosure, valuations are periodically performed, with any subsequent write-downs recorded as a valuation allowance and charged to operations. Operating expenses, net of related income, incurred in conjunction with the maintenance of real estate acquired via foreclosure are charged to operations.

Recognition of gains on the sale of real estate is dependent upon the transaction meeting certain criteria relating to the nature of the property and the terms of the sale and potential financing. These gains are included in non-interest income. Losses on disposition of real estate, including expenses incurred in connection with the disposition, are charged to operations.

Allowances For Loan Losses - The Company maintains an allowance for loan losses to absorb probable losses inherent in the loan portfolio. The allowance is based on ongoing assessments of the probable estimated inherent losses. Loans are charged against the allowance when management believes the principal to not be recoverable. The allowance is increased by the provision for loan losses. The provision for loan losses is charged against current period operating results. The allowance is decreased by the amount of charge-offs, net of recoveries. The Company's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances, and the unallocated allowance.

The formula allowance is calculated by applying loss factors to outstanding loans and certain unused commitments. Loss factors reflect management's estimate of the inherent loss in various segments of the loan portfolio. Loss factors are determined based upon various information, including the Company's historical loss experience. Loss factors may be adjusted for factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

Specific allowances are established for loans that are deemed impaired if the fair value of the loan or the collateral or the present value of expected future cash flows is estimated to be less than the Company's investment in the loan. In developing specific valuation allowances, the Company considers (i) the estimated cash payments expected to be received by the Company, (ii) the estimated net sales proceeds from the loan or its collateral, (iii) cost of refurbishment, (iv) certain operating income and expenses, and (v) the costs of acquiring and holding the collateral. The Company charges off a portion of an impaired loan against the specific allowance when that portion is deemed probable to not be recoverable.

The unallocated allowance is based upon management's evaluation of various conditions that are not directly measured in the determination of the formula and specific allowances. The evaluation of the inherent loss with respect to these conditions is subject to a higher degree of uncertainty because they are not identified with specific problem credits or portfolio segments. The

conditions evaluated in connection with the unallocated allowance may include existing general economic and business conditions affecting key lending areas of the Company, the status of the real estate market in California, credit quality trends, delinquencies, collateral values, loan volumes, concentrations, and seasoning, specific industry conditions, recent loss experience, and the duration of the business cycle.

While management uses currently available information to determine the allowance for loan losses, additions to or recoveries from the allowance may be necessary based upon a number of factors including, but not limited to, changes in economic conditions and credit quality trends, particularly in the real estate market, borrower financial status, the regulatory environment, real estate values, and loan portfolio size and composition. Many of these factors are beyond the Company's control and, accordingly, periodic provisions for loan losses may vary from time to time. In addition, various regulatory agencies, as an integral part of the examination process, periodically review the Bank's allowance for loan losses. Such regulatory agencies may develop judgements different from those of management and may require the Bank to recognize additional provisions against operations.

Premises And Equipment - Land is carried at cost. Other premises and equipment are stated at cost, less accumulated depreciation and amortization. The Company depreciates or amortizes premises and equipment on a straight-line basis over the estimated useful lives of the various assets, and amortizes leasehold improvements over the shorter of the asset's useful life or the remaining term of the lease. The useful lives for the principal classes of assets are:

Asset	Useful Life
Buildings	30 to 40 years
Leasehold improvements	Shorter of remaining term of lease or life of improvement
Furniture and equipment	3 to 10 years

The cost of repairs and maintenance is charged to operations as incurred, whereas expenditures that improve or extend the service lives of assets are capitalized.

Impairment Of Long-Lived Assets Other Than Core Deposit Intangibles - Effective January 1, 2002, the Company adopted SFAS No. 144, "Accounting For The Impairment Or Disposal Of Long-Lived Assets". SFAS No. 144 supersedes SFAS No. 121, "Accounting For The Impairment Of Long-Lived Assets And For Long-Lived Assets To Be Disposed Of" and the accounting and reporting provisions of Accounting Principles Board ("APB") No 30, "Reporting The Results Of Operations - Reporting The Effects Of Disposal Of A Segment Of A Business, And Extraordinary, Unusual, And Infrequently Occurring Events And Transactions". SFAS No. 144 unified the accounting treatment for various types of long-lived assets to be disposed of, and resolves implementation issues related to SFAS No. 121. The adoption of SFAS No. 144 did not have a material effect on the Company's financial position, results of operations, or cash flows.

The Company's primary long-lived assets other than core deposit intangibles are its branches and administrative buildings. The Company periodically evaluates the recoverability of these long-lived assets. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use are based on the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less estimated cost to sell.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

Goodwill And Other Intangible Assets - Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill And Other Intangible Assets" which addresses financial accounting and reporting for acquired goodwill and other intangible assets at acquisition in transactions other than business combinations covered by SFAS No.141, and the accounting treatment of goodwill and other intangible assets after acquisition and initial recognition in the financial statements. The adoption of this statement did not have a material effect on the Company's consolidated financial position, results of operations, or cash flows.

The Company's core deposit intangibles represent assets from the acquisition of deposits and are amortized on a straight-line basis over the estimated life of the deposit base acquired, generally seven years. The Company periodically evaluates the periods of amortization to determine whether later events and circumstances warrant revised estimates.

Stock Based Compensation - The Company accounts for its stock option and stock award plans under Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting For Stock-Based Compensation". This Statement establishes financial accounting and reporting standards for stock-based compensation plans. These standards include the recognition of compensation expense over the vesting period of the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No 123 also permits entities to continue to apply the provisions of APB No. 25, Accounting For Stock Issued To Employees, and provide pro forma net earnings (loss) and pro forma net earnings (loss) per share disclosures as if the fair value based method defined in SFAS No. 123 had been applied.

The Company has elected to continue to apply the provisions of APB No. 25 and related interpretations in accounting for stock options and to continue to provide the pro forma disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, in the table below. Under APB No. 25, compensation cost for stock options is measured as the excess, if any, of the fair market value of the Company's common stock at the date of grant over the amount the employee or director must pay to acquire the stock. Because the Company's stock option Plans provide for the issuance of stock options at a price of no less than the fair market value at the date of grant, no compensation cost is required to be recognized for the Company's stock option Plans.

Had compensation costs for the stock options Plans been determined based upon the fair value at the date of grant consistent with SFAS No. 123, net income and earnings per share would have been reduced to the pro forma amounts indicated below. The pro forma amounts presented below were calculated utilizing the Black-Scholes option pricing model, with forfeitures recognized as they occur, incorporating the assumptions detailed on the following page.

(Dollars In Thousands, Except Share Data)	Year
	2002

Net income:		
Before recognized stock compensation expense, net of taxes	$ 5,698	$
Deduct recognized stock compensation expense, net of taxes	($60)	
As reported	$ 5,638	$
Deduct compensation expense from amortization of fair value of all stock options, net of taxes of $87, $160, and $210, in 2002, 2001, and 2000	($124)	
Pro forma	$ 5,514	$
Basic earnings per share:		
As reported	$ 1.67	$
Pro forma	$ 1.64	$
Diluted earnings per share:		
As reported	$ 1.61	$
Pro forma	$ 1.58	$
Shares utilized in Basic EPS calculations	3,369,600	3,27
Shares utilized in Diluted EPS calculations	3,497,150	3,34

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Weighted average assumptions utilized in the Black-Scholes option pricing model for all options granted each year:

	2002	2001	2000
Dividend Yield	0.00%	0.00%	0.00%
Expected stock price volatility	25.00%	35.00%	35.00%
Average risk-free interest rate	3.94%	4.44%	6.11%
Expected option lives	8 years	6 years	8 years

Employee Stock Ownership Plan ("ESOP") - To account for the shares acquired by the Bank's ESOP, the Company recognizes compensation cost equal to the fair value of the ESOP shares during the periods in which they become committed to be released. To the extent that the fair value of the Company's ESOP shares committed to be released differ from the cost of such shares, the differential is charged or credited to equity. Employers with internally leveraged ESOPs such as the Company do not report the loan receivable from the ESOP as an asset and

do not report the ESOP debt from the employer as a liability. The Company's ESOP is a tax-qualified plan. Non-vested shares owned by the ESOP are accounted for via a contra-equity account based upon historic cost. ESOP shares that have not been committed to be released (uncommitted shares) are excluded from outstanding shares on a weighted average basis for earnings per share calculations.

Income Taxes - The Company accounts for income taxes under the liability method. Under this method, deferred tax assets and deferred tax liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying amounts of certain existing assets and liabilities, and their respective bases for Federal income and California franchise taxes. Deferred tax assets and liabilities are calculated by applying current effective tax rates against future deductible or taxable amounts. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in operations in the period that includes the enactment date. Future tax benefits attributable to temporary differences are recognized to the extent the realization of such benefits is more likely than not.

Commissions From Sales Of Non-FDIC Insured Products - The Company realizes commissions from the sales of various non-FDIC insured products, including mutual funds, annuities, and specific securities, as a result of business conducted through Portola. Commission income is typically based upon a percentage of sales. Periodic commission income varies based on the volume and mix of investment products sold, and is recognized on a cash basis.

Earnings Per Share - Basic earnings per share excludes dilution and is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if contracts to issue common stock or securities convertible into common stock were exercised or converted. Dilution resulting from the Company's stock option and stock award plans is calculated using the treasury stock method.

Comprehensive Income - Comprehensive income includes (i) net income and (ii) other comprehensive income. The Company's only source of other comprehensive income is derived from unrealized gains and losses on securities available for sale. The Company displays comprehensive income within the Consolidated Statements of Changes in Stockholders' Equity. Reclassification adjustments result from gains or losses on securities that were realized and included in net income of the current period that also had been included in other comprehensive income as unrealized holding gains or losses in the period in which they arose. Such adjustments are excluded from current period comprehensive income in order to avoid double counting.

Derivative Instruments And Hedging Activities - The Company did not enter into any freestanding derivative contracts, did not conduct any hedging activities, and did not identify any embedded derivatives requiring bifurcation and separate valuation during 2002 or 2001.

Segment Disclosure - The Company operates a single line of business (financial services) with no customer accounting for more than 10% of its revenue and

manages its operation under a unified management and reporting structure. Therefore, no additional segment disclosures are provided.

Reclassifications - Certain reclassifications have been made to prior period financial statements to conform them to the current year presentation.

Recent Accounting Developments

Effective April 1, 2002, the Company adopted SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 145 rescinds and amends these statements to eliminate any inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. SFAS No. 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions including clarification that gains or losses from normal extinguishments of debt need not be classified as extraordinary items. The adoption of SFAS No. 145 did not have a material effect on the Company's financial position, results of operations, or cash flows.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force Issue No. 94-3. The Company will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue No. 94-3, a liability for an exit cost was recognized at the date of the Company's commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amounts recognized.

Effective October 1, 2002, the Company adopted SFAS No. 147, "Acquisitions of Certain Financial Institutions - an Amendment of FASB Statements No. 72 and 144 and FASB Interpretation No.9", which removes acquisitions of financial institutions from the scope of both Statement 72 and Interpretation 9 and requires those transactions be accounted for in accordance with FASB Statements No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets". This Statement is effective for acquisitions on or after October 1, 2002 with earlier application permitted for the transition provisions for previously recorded unidentifiable intangible assets. The adoption of SFAS No. 147 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Effective December 31, 2002 the Company adopted SFAS No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure - an Amendment of FASB Statement No, 123", which provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation and amends the disclosure requirements of No. 123 to require prominent disclosures in both annual and interim financial statements within the Significant Accounting Policies footnote about the method of accounting for stock-based employee compensation and the effect of the method used (intrinsic value or fair value) on reported results. The Company continues to account for stock-based compensation using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and presents the required disclosures in accordance with SFAS No. 123 as amended by SFAS No. 148. The adoption of SFAS No. 148 did not have a material effect on the Company's financial position, results of operations, or cash flows.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are summarized as follows:

	December 31,	
	2002	2001
	(Dollars In Thousands)	
Cash on hand	$ 1,436	$ 1,444
Due from banks	10,011	10,891
Certificates of deposit	--	194
Federal funds sold	--	550
	$ 11,447	$ 13,079

3. INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities are presented below. All securities held are publicly traded.

	December 31, 2002		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
Variable rate corporate trust preferred securities	$ 7,719	$ --	$ (689)

	December 31, 2001		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		

Available for sale			
Variable rate corporate trust preferred securities	$ 7,707	$ --	$ (407)

The following table shows the amortized cost, estimated fair value, and weighted average yield of the Company's investment securities by year of contractual maturity. Actual maturities may differ from contractual maturities due to rights of issuers to call obligations.

	December 31, 2002	
	Amortized Cost	Estimated Fair Value
Available for sale	(Dollars In Thous	
Variable rate corporate trust preferred securities		
Due in 2013 and thereafter	$ 7,719	$ 7,030

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Proceeds from and realized gains and losses on sales of investment securities available for sale are summarized as follows:

	Year Ended December 31,		
	2002	2001	2000
	(Dollars In Thousands)		
Proceeds from sales	$ --	$ --	$ 3,730
Gross realized gains on sales	--	--	--
Gross realized losses on sales	--	--	44

4. MORTGAGE BACKED SECURITIES

The amortized cost and estimated fair value of mortgage backed securities ("MBS") are presented below. Types of mortgage backed securities include pass through certificates ("PT's"), balloon MBS ("Balloon's"), and collateralized mortgage obligations ("CMO's"). All securities held are publicly traded.

	December 31, 2002		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
Fixed rate FHLMC PT's	$ 957	$ 49	$ --
Fixed rate FNMA PT's	452	35	--
Fixed rate GNMA PT's	497	34	--
Variable rate FNMA PT's	3,101	50	--
Fixed rate FHLMC balloons	8,679	48	--
Fixed rate CMO's:			
Agency issuance	23,512	74	(22)
	$37,198	$ 290	$ (22)

	December 31, 2001		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses
	(Dollars In Thousands)		
Available for sale			
Fixed rate FHLMC PT's	$ 1,551	$ 34	$ --
Fixed rate FNMA PT's	585	38	--
Fixed rate GNMA PT's	744	31	--
Variable rate FNMA PT's	4,629	62	--
Fixed rate FHLMC balloons	1,956	--	--
Fixed rate CMO's:			
Agency issuance	17,062	86	--
Non Agency issuance	3,831	35	--
	$30,358	$ 286	$ --

The following table shows the amortized cost, estimated fair value, and weighted average yield of the Company's mortgage backed securities by year of contractual maturity. Actual maturities may differ from contractual maturities due to principal prepayments, priority of principal allocation within collateralized

mortgage obligations, or rights of issuers to call obligations prior to maturity.

	December 31, 20	
	Amortized Cost	Estimated Fair Value
	(Dollars In Thousan	
Available for sale		
Due in 2008 through 2012	$ 9,088	$ 9,164
Due in 2013 and thereafter	28,110	28,302
	$37,198	$37,466

Proceeds from and realized gains and losses on sales of mortgage backed securities available for sale are summarized as follows:

	Year Ended Dece	
	2002	2001
	(Dollars In Tho	
Proceeds from sales	$ 4,500	$ 12,287
Gross realized gains on sales	$ 43	$ 190
Gross realized losses on sales	$ 8	$ --

The Company from time to time pledges mortgage backed securities to the Federal Home Loan Bank as collateral for advances, to the State of California as collateral for certain deposits, to public entities as collateral for certain deposits, and to the Federal Reserve as collateral for certain customer payments. The following table details the amortized cost of mortgage backed securities pledged for various purposes:

	December 31,	
	2002	2001
	(Dollars In Thousands)	
Pledged to the Federal Home Loan Bank	$ --	$ 3,831
Pledged to the State of California	36,119	24,962
Pledged to public funds	376	470
Pledged to the Federal Reserve	703	1,095
	$ 37,198	$ 30,358

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

5. LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable held for investment, net are summarized as follows:

	December
	2002
	(Dollars In T
Loans held for investment:	
Real estate loans:	
Residential one to four unit	$187,471
Multifamily five or more units	118,004
Commercial and industrial	140,027
Construction	69,526
Land	24,801
Sub-total real estate loans	539,829
Other loans:	
Home equity lines of credit	8,779
Loans secured by deposits	265
Consumer lines of credit, unsecured	172
Commercial term loans	5,231
Commercial lines of credit	12,777
Sub-total other loans	27,224
Sub-total gross loans held for investment	567,053
(Less) / Plus:	
Undisbursed construction loan funds	(36,683)
Unamortized purchase premiums, net of purchase discounts	848
Deferred loan fees and costs, net	(1,127)
Allowance for loan losses	(8,162)
Loans receivable held for investment, net	$521,929

The Company serviced various types of loans for others, with the principal balance amounts summarized below:

	December 31,		
	2002	2001	2000
	(Dollars In Thousands)		

Loans serviced for others	$ 35,328	$ 42,637	$ 62,031

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

Activity in the allowance for loan losses is summarized as follows:

	Year Ended December	
	2002	2001
	(Dollars In Thousands)	
Balance, beginning of year	$ 6,665	$ 5,364
Provision for loan losses	1,510	1,400
Charge-offs:		
Residential one to four unit real estate loans	--	--
Consumer lines of credit, unsecured	(11)	(4)
Commercial term loans	(11)	--
Commercial lines of credit	(19)	(95)
Total charge-offs	(41)	(99)
Recoveries:		
Residential one to four unit real estate loans	--	--
Consumer lines of credit, unsecured	5	--
Commercial lines of credit	23	--
Total recoveries	28	--
Balance, end of year	$ 8,162	$ 6,665

The following tables summarizes the Company's recorded investment in impaired loans by type:

	Accrual Status		Non-Accrual Status	
	Principal	Specific Allowances	Principal	Specific Allowances
	(Dollars In Thousands)			
December 31, 2002				
Residential one to four unit	$ --	$ --	$ 201	$ --

Commercial real estate	--	--	2,264	462
Land loans	--	--	129	--
Home equity lines of credit	--	--	49	--
Total	$ --	$ --	$ 2,643	$ 462
December 31, 2001				
Residential one to four unit	$ --	$ --	$ 1,372	$ --
Commercial real estate	--	--	851	--
Consumer lines of credit	--	--	1	--
Business term loans	--	--	28	--
Total	$ --	$ --	$ 2,252	$ --

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

Additional information concerning impaired loans is as follows:

	2002	2001
		(Dollars I
Average investment in impaired loans for the year	$ 3,860	$ 2,304
Interest recognized on impaired loans at December 31	$ 159	$ 146
Interest not recognized on impaired loans at December 31	$ 18	$ 46

Additional information concerning non-accrual loans is as follows:

	2002	2001
		(Dollars In
Interest recognized on non-accrual loans at December 31	$ 159	$ 146
Interest not recognized on non-accrual loans at December 31	$ 18	$ 46

The Company extends loans to executive officers and directors in the ordinary course of business. These transactions were on substantially the same terms as

those prevailing at the time for comparable transactions with unrelated parties and do not involve more than normal risk or unfavorable terms for the Company. An analysis of the activity of these loans is as follows:

	Year Ended December 31,	
	2002	2001
	(Dollars In Thousands)	
Credit commitments, beginning of year	$1,960	$1,724
New term loans and lines of credit	2,498	1,781
Repayments	(400)	(1,195)
Other	(450)	(350)
Credit commitments, end of year	$3,608	$1,960

Under OTS regulations, the Bank may not extend loans to one borrower ("LTOB Limit") in an amount exceeding 15% of the Bank's unimpaired capital and surplus; plus an additional 10% for loans secured by readily marketable collateral. At December 31, 2002 and 2001, the Bank's LTOB Limit was approximately $8,991,000 and $7,623,000, respectively.

The vast majority of the Company's loans are secured by real estate located in California. The Company's credit risk is therefore primarily related to the economic conditions and real estate valuations of this state. Loans are generally made on the basis of a secure repayment source, which is based on a detailed cash flow analysis; however, collateral is generally a secondary source for loan qualification. Under the Company's policy, private mortgage insurance is required for all residential real estate loans with an initial loan to value ratio greater than 80%.

6. INVESTMENT IN CAPITAL STOCK OF THE FEDERAL HOME LOAN BANK

As a member of the Federal Home Loan Bank of San Francisco, the Bank is required to own capital stock in an amount specified by regulation. As of December 31, 2002 and 2001, the Bank owned 46,792 and 29,977 shares, respectively, of $100 par value FHLB stock. The amount of stock owned at December 31, 2002 meets the most recent regulatory determination.

7. ACCRUED INTEREST RECEIVABLE

Accrued interest receivable is summarized as follows:

	Decembe
	2002

	(Dollars In T
Interest receivable on investment securities	$ 31
Interest receivable on mortgage backed securities	168
Interest receivable on capital stock of the Federal Home Loan Bank	47
Interest receivable on loans	2,621
	$ 2,867

8. PREMISES AND EQUIPMENT

Premises and equipment consisted of the following:

	December 31,	
	2002	2001
	(Dollars In Thousands)	
Land	$ 3,213	$ 3,213
Buildings and improvements	4,278	4,257
Equipment	2,993	3,733
Total, at cost	10,484	11,203
Less accumulated depreciation	(3,323)	(3,585)
Premises and equipment, net	$ 7,161	$ 7,618

Depreciation expense was $727 thousand, $663 thousand, and $441 thousand for the years ended December 31, 2002, 2001, and 2000, respectively.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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9. CORE DEPOSIT INTANGIBLES

Core deposit intangibles, net, totaled approximately $0.8 million at December 31, 2002. This balance was comprised of two assets that were generated as a result of the purchase of deposit accounts by the Bank from other financial institutions in December 1996 and April 1998. Each of these assets is being amortized on a straight-line basis over seven years. At December 31, 2002, the Company had no other intangible assets or goodwill.

Additional information regarding the Company's core deposit intangibles is as follows:

	Original Carrying Amount	Accumulated Amortization	Cu Car A
	(Dollars In Thousands)		
1996 Core Deposit Intangible			
Balance at December 31, 2001	$ 3,670	$ 2,665	$
2002 amortization expense		524	
Balance at December 31, 2002	$ 3,670	$ 3,189	$
1998 Core Deposit Intangible			
Balance at December 31, 2001	$ 1,096	$ 587	$
2002 amortization expense		157	
Balance at December 31, 2002	$ 1,096	$ 744	$
Total Core Deposit Intangibles			
Balance at December 31, 2001	$ 4,766	$ 3,252	$
2002 amortization expense		681	
Balance at December 31, 2002	$ 4,766	$ 3,933	$

Estimated future amortization expense for the Company's core deposit intangibles as of December 31, 2002 is as follows:

	1996 Deposit Acquisition	1998 Deposit Acquisition	Total
	(Dollars In Thousands)		
2003	$ 481	$ 157	$ 638
2004	--	157	157
2005	--	38	38
Thereafter	--	--	--
Total	$ 481	$ 352	$ 833

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

10. DEPOSITS

Deposits are summarized as follows:

(Dollars In Thousands)	December 31, 2002	December 31, 2001
Demand deposit accounts	$ 23,549	$ 21,062
NOW accounts	43,629	42,557
Savings accounts	18,474	19,127
Money market accounts	126,061	105,828
Certificates of deposit <$100,000	133,795	156,351
Certificates of deposit $100,000 or more	112,826	87,414
	$458,334	$432,339

The following table sets forth the maturity distribution of certificates of deposit:

	December 31, 2002	
	Balance Less Than $100,000	Balance $100,000 And Over
	(Dollars In Thousands)	
Three months or less	$ 32,421	$ 41,277
Over three through six months	28,370	33,834
Over six through twelve months	30,790	15,632
Over twelve months through two years	27,761	13,831
Over two years through three years	7,533	3,389
Over three years	6,920	4,863
	$ 133,795	$ 112,826

At December 31, 2002 and 2001, respectively, total accounts with balances of $100,000 or greater in deposit products other than certificates of deposit amounted to $84,261,000 and $72,814,000.

Interest expense on deposits is summarized as follows:

	Year Ended December 3	
	2002	2001

	(Dollars In Thousands)	
NOW accounts	$ 149	$ 366
Savings accounts	98	216
Money market accounts	2,419	3,452
Certificates of deposit	7,787	12,415
	$10,453	$16,449

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

11. ADVANCES FROM THE FEDERAL HOME LOAN BANK AND OTHER BORROWINGS

The Bank is a member of the Federal Home Loan Bank ("FHLB") of San Francisco and borrows from the FHLB through various types of collateralized advances. Assets pledged to the FHLB to collateralize advances include the Bank's ownership interest in the capital stock of the FHLB, mortgage backed securities, and various types of qualifying whole loans.

A summary of advances from the FHLB and related maturities follows. All FHLB advances outstanding at December 31, 2002 and December 31, 2001 were overnight or term, bullet maturity, and non-structured advances.

	December 31,	
Year Of Maturity	2002	2001
	(Dollars In Thousands)	
2002	$ --	$13,000
2003	74,000	33,000
2004	12,282	282
2005	1,500	1,500
2006	4,800	4,800
2010	1,000	1,000
	$93,582	$53,582
Weighted average nominal rate	3.02%	4.46%

Additional information concerning advances from the FHLB includes:

2002

(Dollar

Average amount outstanding during the year	$ 57,355
Maximum amount outstanding at any month-end during the year	$ 93,582
Weighted average interest rate during the year	4.25%

Collateral pledged to secured advances from the FHLB is comprised of the following (amortized cost):

	December 31,	
	2002	2001
	(Dollars In Thousands)	
Mortgage backed securities	$ --	$ 3,831
Capital stock in the Federal Home Loan Bank	4,679	2,998
Mortgage loans	346,150	279,539

Other borrowings at December 31, 2002 and 2001 included certain impound accounts totaling $225 thousand and $218 thousand that bear interest at a rate of 2.00%. These accounts are used to pay various costs associated with real property, including property taxes and insurance.

12. LINES OF CREDIT

At December 31, 2002, Monterey Bay Bancorp, Inc. had a revolving line of credit from a correspondent bank of Monterey Bay Bank. The line of credit is for $3.0 million and expires on March 31, 2003. There was no balance outstanding on the line of credit at December 31, 2002. The line of credit is collateralized by eight hundred thousand shares of Monterey Bay Bancorp, Inc.'s treasury stock, which is in the custody of the correspondent bank. The line of credit contains various covenants regarding the maintenance of certain financial conditions and the provision of financial and operating information. This line of credit provides an additional source of liquidity to the Monterey Bay Bancorp, Inc. holding company.

13. INCOME TAXES

The components of the provision for income taxes are summarized as follows:

	Year Ended December 31,	
	2002	2001
	(Dollars In Thousands)	

Current:		
Federal	$ 3,447	$ 2,544
State	944	764
Total current	4,391	3,308
Deferred:		
Federal	(392)	(495)
State	(221)	(26)
Total deferred	(613)	(521)
Provision for income taxes	$ 3,778	$ 2,787

A reconciliation from the statutory federal income and state franchise tax rates to the consolidated effective tax rates, expressed as a percentage of income before income taxes, follows:

	Year Ended	
	2002	2001
Statutory federal income tax rate	35.0%	35.0%
California franchise tax, net of federal income tax benefit	5.0%	7.4%
Other	0.1%	0.2%
Effective income tax rate	40.1%	42.6%

Deferred income taxes reflect the net tax effects of temporary differences, between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Net deferred tax assets are included within other assets on the Consolidated Statements of Financial Condition. The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and liabilities are as follows:

	December 31,	
	2002	2001

	----	----
	(Dollars In Thousands)	
Deferred tax assets:		
Allowance for loan losses	$ 3,266	$ 2,706
Intangible assets	1,174	1,057
Unrealized loss on securities available for sale	173	50
Depreciation	113	93
Deferred compensation	40	46
Other	46	48
Total gross deferred tax assets	4,812	4,000
Deferred tax liabilities:		
FHLB stock dividends	(529)	(441
Deferred loan fees and costs	(220)	(217
Other	(14)	(28
Total gross deferred tax liabilities	(763)	(686
Net deferred tax asset	$ 4,049	$ 3,314

The Company believes that it is more likely than not that it will realize the above deferred tax assets in future periods; therefore, no valuation allowance has been provided against its deferred tax assets.

Legislation regarding bad debt recapture became law in 1996. The law requires recapture of reserves accumulated after 1987, and required that the recapture tax on post-1987 reserves be paid over a six year period starting in 1996. The Company completed this recapture in 2001.

The Bank maintains a tax bad debt reserve of approximately $5.0 million that arose in tax years that began prior to December 31, 1987. This tax bad debt reserve will, in future years, be subject to recapture in whole or in part upon the occurrence of certain events, including, but not limited to:

- a distribution to stockholders in excess of the Bank's current and accumulated post-1951 earnings and profits

- distributions to shareholders in a partial or complete redemption or liquidation of the Bank

- the Bank ceases to be a "bank" or "thrift" as defined under the Internal Revenue Code

The Bank does not intend to make distributions to stockholders that would result in recapture of any portion of its tax bad debt reserve if such recapture would create an additional tax liability. As a result, an associated deferred tax liability has not been recorded for the $5.0 million pre-1988 tax bad debt reserve.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

14. REGULATORY CAPITAL REQUIREMENTS AND OTHER REGULATORY MATTERS

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can result in certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could present a direct material effect upon the Bank's and the Company's financial statements.

The OTS maintains regulations that require the Bank to maintain a minimum regulatory tangible capital ratio (as defined) of 1.50%, a minimum regulatory core capital ratio (as defined) of 4.00% (unless the Bank has been assigned the highest composite rating under the Uniform Financial Institutions Rating System, in which case 3.00%), and a regulatory risk based capital ratio (as defined) of 8.00%. The following table presents a reconciliation as of December 31, 2002 and 2001, between the Bank's capital under accounting principles generally accepted in the United States of America ("GAAP") and regulatory capital as presently defined under OTS regulations, in addition to a review of the Bank's compliance with OTS capital requirements:

(Dollars In Thousands)

	Tangible Capital		Core (Tier One) Capital	
As Of December 31, 2002	Amount	Percent	Amount	Percent
Capital of the Bank presented on a GAAP basis	$ 52,825		$ 52,825	
Adjustments to GAAP capital to derive regulatory capital:				
Net unrealized loss on debt securities classified as available for sale	248		248	
Non-qualifying intangible assets	(833)		(833)	
Qualifying general allowance for loan Losses	--		--	
Bank regulatory capital	52,240	8.57%	52,240	8.57%
Less minimum capital requirement	9,139	1.50%	24,371	4.00%
Regulatory capital in excess of minimums	$ 43,101	7.07%	$ 27,869	4.57%
Additional information:				
Bank regulatory total assets	$ 609,279			
Bank regulatory risk based assets	$ 449,248			

(Dollars In Thousands)

	Tangible Capital		Core (Tier One) Capital	
As Of December 31, 2001	Amount	Percent	Amount	Percent

Capital of the Bank presented on a GAAP basis	$ 45,597		$ 45,597	
Adjustments to GAAP capital to derive regulatory capital:				
Net unrealized loss on debt securities classified as available for sale	71		71	
Non-qualifying intangible assets	(1,514)		(1,514)	
Qualifying general allowance for loan Losses	--		--	
Bank regulatory capital	44,154	8.24%	44,154	8.24%
Less minimum capital requirement	8,040	1.50%	21,440	4.00%
Regulatory capital in excess of minimums	$ 36,114	6.74%	$ 22,714	4.24%
Additional information:				
Bank regulatory total assets	$ 535,998			
Bank regulatory risk based assets	$ 387,892			

The OTS can take prompt corrective action against thrift institutions such as the Bank in the event the institution fails to meet certain regulatory capital thresholds. The prompt corrective action regulations define five specific capital categories based upon an institution's regulatory capital ratios. These five capital categories, in declining order, are "well capitalized", "adequately capitalized", "undercapitalized", "significantly undercapitalized", and "critically undercapitalized". Institutions categorized as "undercapitalized" or worse are subject to certain restrictions, including the requirement to file a capital plan with the OTS, prohibitions on the payment of dividends and management fees, restrictions on executive compensation, and increased supervisory monitoring, among other things. Other restrictions may be imposed on the institution either by the OTS or by the FDIC, including requirements to raise additional capital, sell assets, or sell the entire institution.

As of December 31, 2002 and 2001, the most recent notification from the OTS categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized", the Bank must maintain minimum core capital, tier one risk based, and total risk based capital ratios as presented in the following table. There are no conditions or events since that notification that management believes have changed the Bank's category.

	Actual		For Capital Adequacy Purposes	
As Of December 31, 2002	Amount	Ratio	Amount	Rati
Total Capital (to risk weighted assets)	$ 57,880	12.88%	$ 35,940	8.00
Tier One Capital (to risk weighted assets)	52,240	11.63%	N/A	N/
Core Capital (to adjusted tangible assets)	52,240	8.57%	24,371	4.00
Tangible Capital (to tangible assets)	52,240	8.57%	9,139	1.50
As Of December 31, 2001	Amount	Ratio	Amount	Rati
Total Capital (to risk weighted assets)	$ 49,025	12.64%	$ 31,031	8.00
Tier One Capital (to risk weighted assets)	44,154	11.38%	N/A	N/
Core Capital (to adjusted tangible assets)	44,154	8.24%	21,440	4.00
Tangible Capital (to tangible assets)	44,154	8.24%	8,040	1.50

Management believes that, under current regulations, the Bank will continue to meet its minimum capital requirements in the coming year. However, events beyond the control of the Bank, such as changing interest rates or a downturn in the economy and / or real estate markets where the Bank maintains most of its loans, could adversely affect future earnings and, consequently, the ability of the Bank to meet its future minimum regulatory capital requirements.

OTS rules impose certain limitations regarding stock repurchases and redemptions, cash-out mergers, and any other distributions charged against an institution's capital accounts. The payment of dividends by Monterey Bay Bank to Monterey Bay Bancorp, Inc. is subject to OTS regulations. "Safe-harbor" amounts of capital distributions can be made after providing notice to the OTS, but without needing prior approval. For Tier 1 institutions such as the Bank, an application is not required if the total amount of all capital distributions (including any proposed distribution) for any particular calendar year does not exceed net income for the year to date plus the institution's retained net income for the preceding two years, subject to the Bank's remaining classified as at least "adequately capitalized" following the proposed distribution. Distributions beyond this amount are allowed only with the prior approval of the OTS.

15. COMMITMENTS AND CONTINGENCIES

The Company is involved in certain legal proceedings arising in the normal course of business. In the opinion of management, the outcomes of such proceedings should not have a material adverse effect on the Company's financial position or results of operations.

The Company is a party to financial instruments with off-balance sheet risk in

the normal course of business to meet the financing needs of its customers. These financial instruments include letters of credit, commitments to originate fixed and variable rate loans, lines of credit, and loans in process, and involve, to varying degrees, elements of interest rate risk and credit risk in excess of the amount recognized in the Consolidated Statements of Financial Condition. The Company uses the same credit policies in making commitments to originate loans and lines of credit as it does for on-balance sheet instruments.

At December 31, 2002, the Company had outstanding the following commitments to originate loans and lines of credit:

(Dollars In Thousands) Loan Category	December 31, 2002 Outstanding Commitments
Residential fixed rate mortgages	$ 1,529
Residential variable rate mortgages	4,049
Multifamily five or more units	2,254
Commercial and industrial real estate	2,390
Construction	22,081
Land	102
Home equity lines of credit	42
Commercial term loans	3,845
Commercial lines of credit	3,150
Total	$ 39,442

Commitments to fund loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have expiration dates or other termination clauses. In addition, external market forces may impact the probability of commitments being exercised; therefore, total commitments outstanding do not necessarily represent future cash requirements.

At December 31, 2002, the Company had optional commitments totaling $4.9 million to sell fixed rate residential mortgages to various secondary market purchasers on a servicing released basis. These optional commitments do not expose the Company to financial loss in the event of non-delivery.

At December 31, 2002, the Company had made available various business, personal, and residential lines of credit totaling $37.2 million, of which the undisbursed portion was $15.6 million.

Commercial letters of credit are commitments issued by the Company to guarantee payment by one of the Company's customers, typically for the import of goods. At December 31, 2002, the Company maintained $401 thousand in outstanding commercial letters of credit. No commercial letters of credit were outstanding at December 31, 2001.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. At December 31, 2002 and 2001, the Company maintained no outstanding standby letters of credit.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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At December 31, 2002, the Company maintained no recourse liability for loans previously sold and did not have any losses from any recourse liabilities during 2002 or 2001.

The Company is obligated under non-cancelable operating leases for office space. Certain leases contain escalation clauses providing for increased rentals based primarily on increases in real estate taxes or on the average consumer price index. Rent expense under operating leases, included in occupancy and equipment expense, was $177 thousand, $136 thousand, and $133 thousand for the years ended December 31, 2002, 2001, and 2000, respectively. The increase in rent expense in 2002 was due to the opening of the Los Angeles loan production office.

Certain facilities are leased under the terms of operating leases expiring at various dates through the year 2005. At December 31, 2002, future minimum rental commitments under non-cancelable operating leases were as follows:

	(Dollars In Thousands)
2003	119
2004	66
2005	33
Thereafter	--
Total	$ 218

At December 31, 2002, the Company sub-leased space within its facilities to a total of three parties. The following table presents the minimum scheduled rent obligations by the three parties under non-cancelable operating leases:

	(Dollars In Thousands)
2003	91
2004	89
2005	68
Thereafter	--
Total	$ 248

In the normal course of business, the Company and Bank have negotiated employment agreements with the Chief Executive Officer / President and the Chief Financial Officer / Treasurer. In addition, at December 31, 2002, the Company and Bank also maintained change in control agreements with four officers. These agreements result in severance payments following certain events associated with a change in control of the Company or the Bank.

At December 31, 2002, the Company had indemnification agreements outstanding with each of the Company's Directors, the Chief Executive Officer, and the Chief Financial Officer. These agreements provide indemnification by the Company for certain claims against the Directors and Executive Officers resulting from their service to the Company.

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16. EARNINGS PER SHARE

Basic Earnings Per Share ("EPS") are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. During the years 2000 through 2002, all of the Company's net income was available to common stockholders. The weighted average number of common shares outstanding for the Company is decreased in each reporting period by:

- shares associated with the Company's ESOP which have not been committed to be released
- shares associated with the Company's stock grant programs which are not yet vested to Plan participants
- the weighted average number of Treasury shares maintained by the Company during each period

The computation of Diluted EPS also considers, via the treasury stock method of calculation, the impact of shares issuable upon the assumed exercise of outstanding stock options (both incentive stock options and non-statutory stock options) and stemming from the grant of time-based stock awards under the Company's associated Plans for officers and directors. In calculating diluted earnings per share, no anti-dilutive calculations are permitted and diluted share counts are applicable only in the event of positive earnings. For the years 2000 through 2002, there was no difference in the Company's income used in calculating basic and diluted earnings per share.

The following table reconciles the calculation of the Company's Basic and Diluted EPS for the periods indicated.

	For The Year Ended	
(In Whole Dollars And Whole Shares)	2002	2001
Net income	$5,638,000	$ 3,751,000
Average shares issued	4,492,085	4,492,085
Less weighted average:		
Uncommitted ESOP shares	(89,844)	(125,781
Non-vested stock award shares	(15,772)	(28,413
Treasury shares	(1,016,869)	(1,062,588
Sub-total	(1,122,485)	(1,216,782

Weighted average BASIC shares outstanding	3,369,600	3,275,303
Add dilutive effect of:		
Stock options	126,127	67,121
Stock awards	1,423	809
Sub-total	127,550	67,930
Weighted average DILUTED shares outstanding	3,497,150	3,343,233
Earnings per share:		
BASIC	$ 1.67	$ 1.15
DILUTED	$ 1.61	$ 1.12

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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17. OTHER COMPREHENSIVE INCOME

The Company's only source of other comprehensive income has been derived from unrealized gains and losses on the portfolios of investment and mortgage backed securities classified as available for sale.

Reclassification adjustments for the change in net gains (losses) included in other comprehensive income from investment and mortgage backed securities classified as available for sale during the past three years are summarized as follows:

	Year Ended Dec	
	2002	2001
	(Dollars In Th	
Gross reclassification adjustment	$ 35	$ 190
Tax (expense) benefit	(15)	(78
Reclassification adjustment, net of tax	$ 20	$ 112

A reconciliation of the net unrealized gain or loss on available for sale securities recognized in other comprehensive income is as follows:

	Year E
	2002
	(Dolla
Holding (loss) gain arising during the year, net of tax	$ (157)
Reclassification adjustment, net of tax	(20)
Net unrealized (loss) gain recognized in other comprehensive income	$ (177)

18. STOCK BENEFIT PLANS

Stock Option Programs - The Company's stock option programs have all been approved by the Company's stockholders and provide for the issuance of options to directors and employees only, and not to any unaffiliated individuals or entities.

In 1995, the 1995 Incentive Stock Option Plan ("Stock Option Plan") was approved. Under the Stock Option Plan, the Company may grant to officers and employees of the Company and its subsidiary, the Bank, both non-statutory and incentive stock options, as defined under the Internal Revenue Code, to purchase shares of the Company's common stock.

In 1995, the 1995 Stock Option Plan For Outside Directors (the "Directors Option Plan") was also approved. Under the Directors' Option Plan, directors who are not officers or employees of the Company or Bank may be granted non-statutory stock options to purchase up to 97,929 shares of the Company's common stock.

On May 25, 2000, the stockholders of the Company approved amendments to the Stock Option Plan. These amendments included:

- an increase in the number of shares reserved for issuance under the Stock Option Plan to 660,000 shares

- an increase in the strike price of options granted under the Stock Option Plan from not less than 100% of the fair market value of the common stock on the date of grant (except that the exercise price for beneficial owners of more than 10.0% of the outstanding voting stock of the Company must be equal to 110% of the fair market value of the common stock on the date of grant) to at least 110% of the fair market value of the common stock on the date of grant for all grants occurring on or after May 25, 2000

- providing additional flexibility in the vesting schedule for both incentive and non-statutory stock options

- allowing non-employee directors to be eligible for the grant of non-statutory stock options under the Stock Option Plan

Options granted under the Stock Option Plan prior to May 25, 2000 entitle the holder to purchase one share of the common stock at the fair market value of the common stock on the date of grant. Options granted under the Stock Option Plan prior to May 25, 2000 begin to vest one year after the date of grant ratably over five years and expire no later than ten years after the date of grant.

Options granted under the Stock Option Plan after May 24, 2000 entitle the holder to purchase one share of the common stock at 110% of the fair market value of the common stock on the date of grant. Options granted under the Stock Option Plan after May 24, 2000 vest at various times as specified under each individual option agreement and expire no later than ten years after the date of grant.

Options granted under the Directors Option Plan entitle the holder to purchase one share of the common stock at the fair market value of the common stock on the date of grant. Options begin to vest one year after the date of grant ratably over five years and expire no later than ten years after the date of grant.

As of December 31, 2002, there were 1,500 non-statutory stock options issued under the Stock Option Plan granted to an individual owning more than 10.0% of the Company's common shares then outstanding. However, restrictions contained in the Company's Articles Of Incorporation limit the combined voting power of the Company common stock owned by this individual, who was a Director of the Company at December 31, 2002, to no more than 10.0% of the total combined voting power of the Company's common stock.

During the years ended December 31, 2002, 2001, and 2000, the Company did not amend the terms or conditions of any existing stock option grant. The Company has never repriced a stock option following its issuance.

All options under the Stock Option Plan become 100% exercisable in the event that the employee terminates his employment due to death, disability, or, to the extent not prohibited by the OTS, in the event of a change in control of the Company or the Bank.

All options under the Directors Option Plan become 100% exercisable in the event that the director terminates membership on the board of directors due to death, disability, or, to the extent not prohibited by the OTS, in the event of a change in control of the Company or the Bank.

The status of the aggregate stock options under the two Plans as of December 31, 2002, 2001, and 2000, and changes during the years then ended, are presented

below. The abbreviation "FMV" represents "fair market value" and the abbreviation "N/A" represents "not applicable".

	December 31,			
	2002		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding at the beginning of the year	425,104	$11.02	550,236	$10.19
Granted	18,500	$19.19	82,750	$15.19
Forfeited	25,249	$14.43	92,271	$12.03
Exercised	48,463	$10.20	115,611	$ 9.11
Options outstanding at year end	369,892	$11.31	425,104	$11.02
Options outstanding at year end:				
Granted at 100% FMV	222,242	$ 9.55	270,354	$ 9.71
Granted at 110% FMV	147,650	$13.95	154,750	$13.32
Total	369,892	$11.31	425,104	$11.02
Options exercisable at year end:				
Granted at 100% FMV	162,416	$ 9.58	184,932	$ 9.65
Granted at 110% FMV	84,194	$13.84	70,292	$14.10
Total	246,610	$11.04	255,224	$10.88
Options available for future grants	143,813		137,064	
Weighted average remaining contractual life of options outstanding at year end	5.5 years		6.2 years	
Weighted average fair value for options granted during the year at 100% of FMV:	N/A		N/A	
Weighted average fair value for options granted during the year at 110% of FMV:	$6.00		$5.08	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The following table summarizes information about the stock options outstanding at December 31, 2002:

Options Granted At 100% Of Fair Market Value:

Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life In Years	Number Exercisable
$ 8.19	45,000	7.3	18,000
$ 9.10	103,353	2.6	103,353
$ 9.50	9,658	3.5	9,658
$ 9.69	9,941	7.2	3,974
$10.13	40,000	7.1	16,000
$14.80	9,375	5.5	7,500
$16.60	4,915	5.2	3,931
$8.19 - $16.60	222,242	4.8	162,416

Options Granted At 110% Of Fair Market Value:

Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life In Years	Number Exercisable
$ 9.90	10,000	7.4	4,000
$11.21	37,400	7.9	14,600
$11.76	20,000	3.7	18,344
$12.62	8,000	8.5	1,600
$15.88	50,250	4.7	43,650
$16.26	3,000	8.7	600
$16.64	1,000	9.0	1,000
$16.82	2,000	9.0	400
$17.09	500	9.1	--
$17.73	2,000	9.2	--
$17.81	3,000	9.2	--
$19.26	1,000	9.4	--
$20.13	8,000	10.0	--
$20.19	1,000	9.7	--
$21.89	500	9.9	--
$9.90 - $21.89	147,650	6.5	84,194
TOTAL	369,892	5.5	246,610

Stock Award Programs - The Company maintains a Performance Equity Program ("PEP") for officers and employees. The Company also maintained a Recognition

and Retention Plan for Outside Directors ("RRP") that was terminated during 2000. These stock award Plans were designed to provide directors, officers, and employees with a proprietary interest in the Company in a manner designed to encourage such persons to remain with the Company and to improve the financial performance of the Company. These stock award plans were approved by the Company's stockholders.

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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

The Bank contributed $1.7 million during the fourth quarter of 1995 and the first quarter of 1996 to purchase 179,687 shares of Company common stock in the open market at a weighted average cost of $9.62 per share. This contribution was initially recorded as a reduction in stockholders' equity and then is ratably charged to compensation expense over the vesting period of the actual stock awards. Of the 179,687 shares acquired, 38,010 were allocated to the RRP, with the remaining 141,677 allocated to the PEP.

The PEP provides for two types of stock awards: time-based grants and performance-based grants. Time-based grants vest pro-rata on each anniversary of the grant date and become fully vested over the applicable time period as determined by the board of directors, typically five years. Vesting of performance-based grants is dependent upon achievement of criteria established by the board of directors for each stock award.

All stock awards granted will be immediately vested in the event the recipient terminates his employment (or in the case of a director, his service, including service as a Director Emeritus) due to death, disability, or a change in control of Monterey Bay Bank or Monterey Bay Bancorp, Inc. In the event the award recipient terminates his employment or service due to any reason other than death, disability, or a change in control, all unvested stock awards become null and void. In addition, to the extent that criteria for performance-based stock awards are not achieved, associated awards are forfeited and become available for re-issuance.

Periodic operating expense for time-based stock awards is recognized based upon fair market value at date of grant. Periodic operating expense for performance-based stock awards is recognized based upon fair market value at the earlier of the reporting date or the performance measurement date.

During 2002, 2001, and 2000, the Company utilized previously unallocated shares under the PEP to compensate certain employees for their favorable performance. These shares were granted in lieu of cash incentive compensation and vested immediately. During the years ended December 31, 2002, 2001, and 2000, the Company made no changes to the terms or conditions of existing stock award grants.

A summary of the PEP as of December 31, 2002, 2001, and 2000, and changes and related expense during the years ended on those dates, is presented below:

2002	20

Stock awards outstanding at the beginning of the year	17,969	35,0
Stock award activity during the year:		
Time based shares granted	--	
Performance based shares granted	--	
Performance based shares granted in lieu of cash compensation	1,483	9,4
Performance based shares immediately vested upon grant	(1,483)	(9,4
Time based shares forfeited	(634)	(6,3
Performance based shares forfeited	(849)	(3,1
Time based shares vested	(2,717)	(4,2
Performance based shares vested	(2,000)	(3,3
Stock awards outstanding at the end of the year	11,769	17,9
Available for future awards at the end of the year	--	
PEP compensation expense (Dollars In Thousands)	$ 100	$ 2

In 2000, the remaining 9,541 shares in the RRP were vested and the Company recognized $66 thousand in related compensation expenses.

Employee Stock Ownership Plan and Trust - The Company established for eligible employees an Employee Stock Ownership Plan and Trust ("ESOP"), which became effective upon the conversion of the Bank from a mutual to a stock association. Employees who have been credited with at least 1,000 hours of service during a twelve month period, have attained age twenty-one, and were employed on the last business day of the calendar year are eligible to participate.

The ESOP subscribed for 8.0% (or 359,375) of the shares of Company common stock issued in the Conversion at an adjusted price of $6.40 per share. During 1995, the ESOP borrowed $2.3 million from Monterey Bay Bancorp, Inc. in order to fund the purchase of the common stock. This loan is being repaid pro-rata over an approximately ten year period concluding on December 31, 2004, with the funds for repayment primarily coming from the Bank's contributions to the ESOP over a similar time period. The loan is collateralized by the shares of common stock held by the ESOP.

As an internally leveraged ESOP, no interest income or interest expense is recognized on the loan in the consolidated financial statements of the Company. Annual principal payments of $230,000 are scheduled for the conclusion of each calendar year in conjunction with a release of shares for allocation to individual employee accounts. Shares are allocated on the basis of eligible compensation, as defined in the ESOP plan document, in the year of allocation. Benefits generally become 100% vested after three years of credited service. Employees with at least one, but fewer than three, years of credited service

receive a partial vesting according to a sliding schedule. However, in the event of retirement, disability, or death, any unvested portion of benefits shall vest immediately. Any share forfeitures are allocated among participating employees in the same proportion as annual share allocations. Benefits are payable upon separation from service based on vesting status and share allocations made.

As of December 31, 2002, 287,500 shares had been cumulatively allocated to participants and committed to be released. As of December 31, 2002, the fair market value of the 71,875 unearned shares was $1.4 million based upon a closing market price per share of $19.95. The outstanding ESOP loan balance, which is not a component of the Company's consolidated financial statements, was $460 thousand at December 31, 2002.

Periodic operating expense associated with the ESOP is recognized based upon:

- the number of Company common shares pro-rata allocated
- the fair market value of the Company's common stock at the dates shares are committed to be released
- any dividends received on unallocated shares as a reduction to periodic operating expense

The benefits expenses, not including administrative costs, related to the ESOP for the years ended December 31, 2002, 2001, and 2000 were $638 thousand, $437 thousand, and $317 thousand, respectively. At December 31, 2002 and 2001, the unearned compensation related to the ESOP was $460 thousand and $690 thousand, respectively. These amounts are shown as a reduction of stockholders' equity in the Consolidated Statements Of Financial Condition.

19. 401(K) PLAN

The Company maintains a tax deferred employee savings plan under Section 401(k) of the Internal Revenue Code. All employees are eligible to participate who are 21 years of age, have been employed by the Company for at least 30 days, and are scheduled to complete 1,000 hours of service or more per calendar year. While the 401(k) Plan allows the Company to provide periodic or matching contributions to employee accounts within the 401(k) Plan, no such contributions were made in the years 2000 through 2002.

The trust that administers the 401(k) Plan had assets of approximately $1.7 million and $1.7 million as of December 31, 2002 and 2001, respectively. None of these assets have been maintained at the Company or its subsidiary. At December 31, 2002, 401(k) Plan participants were able to invest in one or more of a total of twelve different investment alternatives at their discretion. One of the investment alternatives is the Company's common stock. The 401(k) Plan also allows participants to borrow funds, subject to certain limitations.

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20. RETIREMENT PLAN

In January 2003, following Board of Director approval, the Company established a supplemental retirement plan ("Plan") covering two key executives. The Plan is a non-qualified defined benefit plan and is unfunded. The Plan has no assets, and the benefits payable under the Plan are not secured. The Plan participants are general creditors of the Company in regards to their vested Plan benefits. The Plan provides for retirement benefits upon reaching age 65, and the two participants are fully vested at the inception of the Plan.

During December 2002, the Company purchased Bank owned life insurance on the lives of the two participants. The cash surrender value of the ten life insurance policies purchased aggregated $9,036,000 at December 31, 2002. The Company intends to utilize the increase in cash surrender value of these insurance policies to fund the retirement benefit obligations. There is no accrued pension obligation included in the accompanying financial statements at December 31, 2002, as the Plan was not established until January 2003.

21. PARENT COMPANY ONLY CONDENSED FINANCIAL INFORMATION

The Parent Company (Monterey Bay Bancorp, Inc.) and its subsidiary, the Bank, file consolidated federal income tax returns in which the taxable income or loss of the Parent Company is combined with that of the Bank. The Parent Company's share of income tax expense is based on the amount which would be payable if separate returns were filed. Accordingly, the Parent Company's equity in the net income of its subsidiaries (distributed and undistributed) is excluded from the computation of the provision for income taxes for stand alone financial statement purposes.

The condensed financial statements of Monterey Bay Bancorp, Inc. (parent company only) are summarized as follows:

CONDENSED STATEMENTS OF FINANCIAL CONDITION

	December 31,	
	2002	2001
	(Dollars In Thousands)	
ASSETS:		
Cash and due from depository institutions	$ 3,314	$ 4,619
Other assets	6	1
Investment in subsidiary	52,825	45,597
TOTAL ASSETS	$56,145	$50,217
LIABILITIES AND STOCKHOLDERS' EQUITY:		
Liabilities	$ 42	$ 55
Stockholders' equity	56,103	50,162
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$56,145	$50,217

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

CONDENSED STATEMENTS OF INCOME AND
COMPREHENSIVE INCOME

	Year End	
	2002	
	(Dollars	
Interest income:		
Interest on mortgage backed securities and investment securities	$ --	$
Interest on loan receivable	--	
Other interest income	15	
Total interest income	15	
Interest expense - borrowings	10	
Net interest income before benefit for loan losses	5	
Benefit for loan losses	--	
Net interest income after benefit for loan losses	5	
Loss on sale of mortgage backed securities available for sale	--	
Non-interest expense	442	
Loss before benefit for income taxes	(437)	
Benefit for income taxes	(180)	
Loss before undistributed net income of subsidiary	(257)	
Undistributed net income of subsidiary	5,895	4
Net income	$5,638	$3
Other comprehensive (loss) income	(177)	
Total comprehensive income	$5,461	$4

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

CONDENSED STATEMENTS OF CASH FLOWS

	Year End	
	2002	
	(Dollar	
OPERATING ACTIVITIES:		
Net income	$ 5,638	$ 3
Adjustments to reconcile net income to net cash provided by operatingactivities:		
Undistributed net income of subsidiary	(5,895)	(4
Benefit for loan losses	--	
Loss on sale of securities	--	
Cash receipts associated with ESOP	230	
(Increase) decrease in other assets	(5)	
Tax benefit arising from stock option exercises	130	
Other, net	178	
Net cash provided by operating activities	276	
INVESTING ACTIVITIES:		
Proceeds from repayments of loans	--	
Investment in subsidiary	(1,000)	
Principal repayments on mortgage backed securities available for sale	--	
Proceeds from sales of mortgage backed securities available for sale	--	
Net cash (used in) provided by investing activities	(1,000)	
FINANCING ACTIVITIES:		
(Repayments) proceeds of borrowings, net	--	
Cash dividends paid to stockholders	--	
Sales of treasury stock for exercise of stock options	494	1
Purchases of treasury stock	(1,075)	
Net cash (used in) provided by financing activities	(581)	1
NET (DECREASE) INCREASE IN CASH & CASH EQUIVALENTS	(1,305)	
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	4,619	3

CASH & CASH EQUIVALENTS AT END OF YEAR	$ 3,314	$ 4
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MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

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22. ESTIMATED FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company, using available market information and appropriate valuation methodologies. However, considerable judgement is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different assumptions and / or estimation methodologies may have a material effect on the estimated fair value amounts.

The following methods and assumptions were used by the Company in computing the estimated fair values:

Cash And Cash Equivalents - Current carrying amounts approximate estimated fair value.

Investment Securities and Mortgage Backed Securities - Fair values of these securities are based on year-end market prices or dealer quotes. If quoted market prices are not available, estimated fair values were based upon quoted market prices of comparable instruments.

Loans Held For Sale - Fair values of these loans are based on prices in the secondary market for similar residential mortgages.

Loans Receivable Held For Investment - For fair value estimation purposes, these loans have been categorized by type of loan (e.g., one to four unit residential) and then further segmented between adjustable or fixed rates. Where possible, the fair value of these groups of loans has been based on secondary market prices for loans with similar characteristics. The fair value of the remaining loans has been estimated by discounting the future cash flows using current interest rates being offered for loans with similar remaining terms to borrowers of similar credit quality. Prepayment estimates were based on historical experience and published data for similar loans.

Capital Stock Of The Federal Home Loan Bank - Fair value is based upon its redemption value, which equates to current carrying amounts.

Transaction Deposit Accounts - The estimated fair value of checking, savings, and money market deposit accounts is the amount payable on demand at the reporting dates.

Certificates Of Deposit - Fair value has been estimated by discounting the contractual cash flows using current market rates for similar time deposits with comparable remaining terms.

FHLB Advances - Fair value was estimated by discounting the contractual cash

flows using current market rates offered for advances with comparable conditions and remaining terms.

Other Borrowings - Current carrying amounts approximate estimated fair value.

Off-Balance Sheet Instruments - The estimated fair values of commitments to fund loans and commercial letters of credit are estimated using the fees currently charged to enter into similar agreements, considering the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed rate loan commitments, the estimated fair values also incorporate the difference between current levels of interest rates for similar commitments and the committed rates. The fair value of such off-balance sheet instruments were not significant as December 31, 2002 and 2001 and therefore have not been included in the following table.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

The carrying amounts and estimated fair values of the Company's financial instruments are as follows:

	December 31, 2002		D
	Carrying Amount	Estimated Fair Value	C
		(Dollars In Thousan	
ASSETS:			
Cash and cash equivalents	$ 11,447	$ 11,447	$
Investment securities available for sale	7,030	7,030	
Mortgage backed securities available for sale	37,466	37,466	
Loans held for sale	1,545	1,571	
Loans receivable held for investment, net	521,929	535,024	
FHLB stock	4,679	4,679	
LIABILITIES:			
Transaction deposit accounts	211,713	211,713	
Certificates of deposit	246,621	248,794	
Advances from the Federal Home Loan Bank	93,582	95,628	
Other borrowings	223	223	

The fair value estimates presented herein are based upon pertinent information available to management as of December 31, 2002 and 2001. The fair value amounts have not been comprehensively reevaluated since the reporting date. Therefore, current estimates of fair value and the amounts realizable in current secondary market transactions may differ significantly from the amounts presented herein.

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

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23. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following is a summary of quarterly results:

	First Quarter	Second Quarter	Thir Quarte
	(Dollars In Thousands, Except		
Year Ended December 31, 2002:			
Interest and dividend income	$ 8,755	$ 8,891	$ 8,97
Interest expense	3,405	3,328	3,18
Provision for loan losses	325	385	40
Non-interest income	512	503	49
Non-interest expense	3,466	3,404	3,44
Provision for income taxes	866	930	97
Net income	1,205	1,347	1,46
Shares applicable to Basic earnings per share	3,348,387	3,375,688	3,384,52
Basic earnings per share	$ 0.36	$ 0.40	$ 0.4
Shares applicable to Diluted earnings per share	3,465,286	3,509,181	3,509,11
Diluted earnings per share	$ 0.35	$ 0.38	$ 0.4
Cash dividends paid per share	$ --	$ --	$ -

	First Quarter	Second Quarter	Thir Quarte
	(Dollars In Thousands, Except		
Year Ended December 31, 2001:			
Interest and dividend income	$ 9,996	$ 9,710	$ 9,75
Interest expense	5,244	4,937	4,74
Provision for loan losses	500	300	27
Non-interest income	643	695	69
Non-interest expense	3,843	3,520	3,58
Provision for income taxes	450	699	78
Net income	602	949	1,05
Shares applicable to Basic earnings per share	3,227,241	3,262,003	3,293,85
Basic earnings per share	$ 0.19	$ 0.29	$ 0.3
Shares applicable to Diluted earnings per share	3,274,559	3,300,595	3,385,55
Diluted earnings per share	$ 0.18	$ 0.29	$ 0.3
Cash dividends paid per share	$ --	$ --	$ -

MONTEREY BAY BANCORP, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000 (Continued)

Item 9. Changes In And Disagreements With Accountants On Accounting And Financial Disclosure.

None.

PART III

Item 10. Directors And Executive Officers Of The Registrant.

The information relating to Directors and Executive Officers of the Registrant is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2003, which will be filed no later than 120 days following Registrant's fiscal year end. Information concerning Executive Officers who are not Directors is also contained in Part I of this report pursuant to paragraph (b) of Item 401 of Regulation S-K in reliance on Instruction G.

Item 11. Executive Compensation.

The information relating to Director and Executive Officer compensation is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2003, excluding the Compensation Committee Report on Executive Compensation and the Stock Performance Graph, which will be filed no later than 120 days following the Registrant's fiscal year end.

Item 12. Security Ownership Of Certain Beneficial Owners And Management.

The information relating to security ownership of certain beneficial owners and management is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2003, which will be filed no later than 120 days following the Registrant's fiscal year end.

Item 13. Certain Relationships And Related Transactions.

The information relating to certain relationships and related transactions is incorporated herein by reference to the Registrant's Proxy Statement for the Annual Meeting of Stockholders to be held on May 22, 2003, which will be filed no later than 120 days following the Registrant's fiscal year end.

Item 14. Controls And Procedures.

(a) The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports in compliance with the Securities Exchange Act of 1934, as amended

("Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms, and that such information is accumulated and communicated to the Company's Management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure based closely on the definition of "disclosure controls and procedures" in Rule 13a-14(c) promulgated under the Exchange Act. Within 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

(b) There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the internal controls subsequent to the date of the evaluation referenced in paragraph (a) above.

PART IV

Item 15. Exhibits, Financial Statement Schedules, And Reports On Form 8-K.

(a)(1) Financial Statements

The following consolidated financial statements of the Registrant are filed as a part of this document under Item 8, "Financial Statements and Supplementary Data."

Independent Auditors' Report

Consolidated Statements Of Financial Condition At December 31, 2002 And 2001.

Consolidated Statements of Income For Each Of The Years In The Three Year Period Ended December 31, 2002.

Consolidated Statements Of Changes In Stockholders' Equity For Each Of The Years In The Three Year Period Ended December 31, 2002.

Consolidated Statements Of Cash Flows For Each Of The Years In The Three Year Period Ended December 31, 2002.

Notes To Consolidated Financial Statements.

(a)(2) Financial Statement Schedules

Financial Statement Schedules have been omitted because they are not

applicable or the required information is shown in the Consolidated Financial Statements or Notes thereto under Item 8, "Financial Statements and Supplementary Data."

(a)(3) Management Contracts (see Item 15 (c), below)

(b) Reports On Form 8-K Filed During The Last Quarter Of The Registrant's Fiscal Year Ended December 31, 2002

(1) Form 8-K dated October 21, 2002. This Current Report reported the Company's financial and operating results for the three month and nine month periods ending September 30, 2002.

(c) Exhibits Required by Securities and Exchange Commission Regulation S-K

Exhibit Number	Description
3.1	Certificate Of Incorporation Of Monterey Bay Bancorp, Inc. (1)
3.4	Amended And Restated Bylaws Of Monterey Bay Bancorp, Inc. Effective October 24, 2002 (2)
4.0	Stock Certificate Of Monterey Bay Bancorp, Inc. (1)
10.9	Monterey Bay Bank 401(k) Plan (1)
10.11	Monterey Bay Bank Performance Equity Program (3)
10.13	Monterey Bay Bancorp, Inc. 1995 Incentive Stock Option Plan As Amended And Restated Effective May 25, 2000 (4)
10.14	Monterey Bay Bancorp, Inc. 1995 Stock Option Plan For Outside Directors (3)
10.21	Employment Agreement With C. Edward Holden (5)
10.22	Employment Agreement With Mark R. Andino (5)
10.23	Monterey Bay Bancorp, Inc. Form Of Indemnification Agreement Between The Company And All Directors Plus The Chief Financial Officer (2)
10.24	Monterey Bay Bank Form Of Indemnification Agreement Between The Bank And All Directors Plus The Chief Financial Officer (2)
10.26	Form Of Salary Continuation, Split Dollar, And Executive Bonus

	Agreement Between Monterey Bay Bancorp, Inc., Monterey Bay Bank, And Two Executive Officers Dated January 1, 2003
10.27	Form Of Change In Control Agreement Between Monterey Bay Bancorp, Inc., Monterey Bay Bank, And Five Officers Effective March 22, 2003
21	Subsidiary information is incorporated herein by reference to "Part I - Subsidiaries"
23	Consent Of Deloitte & Touche LLP, Independent Auditors
99.1	Certification Of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act Of 2002
99.2	Certification Of Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act Of 2002

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(1) Incorporated herein by reference from the Exhibits to the Registration Statement on Form S-1, as amended, filed on September 21, 1994, Registration No. 33-84272.

(2) Incorporated herein by reference from the Exhibits to the Quarterly Report on Form 10-Q for September 30, 2002 filed on November 12, 2002.

(3) Incorporated herein by reference from the Proxy Statement for the Annual Meeting of Stockholders' filed on July 26, 1995.

(4) Incorporated herein by reference from the Proxy Statement for the Annual Meeting of Stockholders' filed on April 14, 2000.

(5) Incorporated herein by reference from the Exhibits to the Quarterly Report on Form 10-Q for March 31, 2002 filed on May 13, 2002

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MONTEREY BAY BANCORP, INC.

Date: March 27, 2003 By: /s/ C. Edward Holden

C. Edward Holden
Vice Chairman, Director, Chief Executive Officer, President

Pursuant to the requirements of the Securities and Exchange Act of

1934, this report has been signed by the following persons on behalf of the Registrant in the capacities and on the dates indicated.

Name	Title
/s/ McKenzie Moss McKenzie Moss	Chairman of the Board of Directors
/s/ C. Edward Holden C. Edward Holden President	Vice Chairman, Director, Chief Executive Officer,
/s/ Mark R. Andino Mark R. Andino	Chief Financial Officer, Treasurer (Principal Financial and Accounting Officer)
/s/ Rita Alves Rita Alves	Director
/s/ Josiah T. Austin Josiah T. Austin	Director
/s/ Edward K. Banks Edward K. Banks	Director
/s/ Diane S. Bordoni Diane S. Bordoni	Director
/s/ Larry A. Daniels Larry A. Daniels	Director
/s/ Steven Franich Steven Franich	Director
/s/ Stephen G. Hoffmann Stephen G. Hoffmann	Director
/s/ Gary L. Manfre Gary L. Manfre	Director

CERTIFICATIONS

Certification of the Principal Executive Officer

(Section 302 of the Sarbanes-Oxley Act of 2002)

I, C. Edward Holden, Chief Executive Officer and President, certify that:

1. I have reviewed this annual report on Form 10-K of Monterey Bay Bancorp, Inc.;

2. Based on my knowledge, this annual report does not contain and untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors and any material weakness in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 27, 2003

By: /s/ C. Edward Holden

C. Edward Holden
Chief Executive Officer
President
Vice Chairman

Certification of the Principal Financial Officer
(Section 302 of the Sarbanes-Oxley Act of 2002)

I, Mark R. Andino, Chief Financial Officer and Treasurer, certify that:

1. I have reviewed this annual report on Form 10-K of Monterey Bay Bancorp, Inc.;

2. Based on my knowledge, this annual report does not contain and untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

   c. presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors and any material weakness in internal controls; and

   b. any fraud, whether or not material, that involves management or other

employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: March 27, 2003

By: /s/ Mark R. Andino

Mark R. Andino
Chief Financial Officer
Treasurer